STATE OF ARIZONA
NOTES TO THE FINANCIAL STATEMENTS
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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the State of Arizona (the State) conform to generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board (GASB). During the year ended June 30, 2002, the State implemented *GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, as amended by GASB Statement No. 37*, which prescribes a new reporting model consisting of both government-wide and fund financial statements. The State also implemented *GASB Statement No. 35, Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities-an amendment of GASB Statement No. 34* and *GASB Statement No. 38, Certain Financial Statement Note Disclosures*, which prescribes new and revised note disclosures.

A. REPORTING ENTITY

The State of Arizona is a general purpose government. The accompanying financial statements present the activities of the State (the primary government) and its component units.

Component units are legally separate entities for which the State is considered to be financially accountable. Blended component units, although legally separate entities, are in substance part of a government's operations. Therefore, data from these units is combined with data of the primary government. The State has no blended component units. Discretely presented component units, however, are reported in a separate column in the government-wide statements to emphasize they are legally separate from the State. Each discretely presented component unit discussed below has a June 30 year-end, with the exception of the State Compensation Fund. The State Compensation Fund's financial information is for the calendar year ended December 31, 2001.

The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the State to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the State.

Discretely Presented Component Units

State Compensation Fund – The State Compensation Fund provides insurance to employers for workers' compensation, occupational disease compensation, and medical, surgical and hospital benefits. The Fund is governed by a board of directors that consists of five members appointed by the Governor for staggered terms of five years. Annually, the Governor appoints a chairman from among the board members. The State is required by statute to review and approve the operating and capital outlay budget of the Fund. Complete financial statements may be obtained from the State Compensation Fund's administrative offices.

State Compensation Fund
3031 North 2nd Street
Phoenix, Arizona 85012
(602) 631-2000

University Medical Center (UMC) – The UMC is the primary teaching hospital for the College of Medicine, College of Nursing and the College of Pharmacy of the University of Arizona. UMC was created in 1984 when the State Legislature passed a bill that allowed the Arizona Board of Regents (ABOR) to convey the UMC to a not-for-profit corporation. Although an autonomous entity was created, the teaching missions and research alliances with the University of Arizona and the State of Arizona remained. The ABOR confirms all members of UMC's Board of Directors, and must approve all amendments to the UMC's articles of incorporation and bylaws. Complete financial statements may be obtained from the University Medical Center's administrative offices.

The University Medical Center
655 East River Road
Tucson, Arizona 85704
(520) 694-2700

Arizona Power Authority (APA) – The APA purchases the State's allocation of power produced at the federally owned Boulder Canyon Project hydroelectric power plant and resells it to Arizona entities that are eligible purchasers under federal and state laws. The APA is governed by a commission of five electors appointed by the Governor and approved by the Senate. The term of office

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

of each member is six years and the members select a chairman and vice-chairman from among their membership for a term of two years. All revenue bonds issued by the APA must be approved by the State Certification Board. Complete financial statements may be obtained from the Arizona Power Authority's administrative offices.

The Arizona Power Authority
1810 West Adams Street
Phoenix, Arizona 85007-2697
(602) 542-4263

Water Infrastructure Finance Authority (WIFA) – The WIFA is authorized to administer the Clean Water Revolving Fund. The Clean Water Revolving Fund was created pursuant to the Federal Water Pollution Control Act, which required the State to establish the Clean Water Revolving Fund to accept federal capitalization grants for publicly owned wastewater treatment projects. The WIFA has also entered into an agreement with the Environmental Protection Agency to administer the Drinking Water Revolving Fund pursuant to the Safe Drinking Water Act. The WIFA is governed by a twelve-member board of directors appointed by the Governor. Directors serve staggered terms of five years and serve at the pleasure of the Governor. Complete financial statements may be obtained from the Water Infrastructure Finance Authority's administrative offices.

The Water Infrastructure Finance Authority
1100 West Washington, Suite 290
Phoenix, Arizona 85007
(602) 364-1310

Related Organizations

Related organizations are legally separate entities for which the State is not considered to be financially accountable. As a result, financial activity for the organizations described below is not included in the State's financial statements.

Arizona Health Facilities Authority (the Authority) – The Authority issues tax-exempt bonds and loans for the purpose of reducing health care costs and improving health care for Arizona residents by providing less expensive financing for health care institutions. Proceeds from bond issues are loaned to various qualifying nonprofit health care institutions. The health care institutions reimburse the Authority for expenses for issuance of the bonds, pay fees of the Authority, and make payments under the loans for the benefit of the holders of the bonds. The Authority is governed by a seven-member board of directors that is appointed by the Governor and approved by the Senate. The directors serve staggered terms of seven years, and can be removed only for cause.

Arizona International Development Authority (the Authority) – The Authority was established to facilitate the development of international trade or commerce between Arizona and other countries. The Authority is governed by a seven-member board of directors appointed by the Governor for five-year terms, and can be removed only for cause.

Arizona Tourism and Sports Authority – Arizona Revised Statues §5-802 established the Tourism and Sports Authority to construct, finance, maintain, improve, operate, market and promote the use of a multipurpose facility and do all things necessary to accomplish those purposes. The Tourism and Sports Authority may issue revenue bonds in such principal amounts to accomplish the above stated purposes. The Authority is governed by a five-member board of directors that is appointed by the Governor and approved by the Senate. The directors serve terms of five years, and may be re-appointed for one full subsequent term, and can be removed only for cause.

Arizona Housing Finance Authority –Arizona Revised Statutes §41-3902 established the Housing Finance Authority to issue bonds for residential dwelling units and multifamily residential rental projects in rural areas. The Housing and Finance Authority may also establish mortgage credit certificate programs to finance residential dwelling units in rural areas. The Authority is required to notify, and obtain written consent from the governing bodies of any city, town, county, tribal government, or existing corporation for any multifamily residential rental projects planned for their jurisdiction. The Authority is governed by a seven-member board of directors that is appointed by the Governor and approved by the Senate. The directors serve terms of seven years, and can be removed only for cause.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Joint Venture

As described in Note 11, the University of Arizona participates in a joint venture. In accordance with generally accepted accounting principles, the financial activity of this joint venture is not included in the State's financial statements.

B. BASIS OF PRESENTATION

The basic financial statements include both government-wide statements and fund financial statements. The government-wide statements focus on the State as a whole, while the fund financial statements focus on major funds. Each presentation provides valuable information that can be analyzed and compared between years and between governments to enhance the usefulness of the information.

Government-wide statements - provide information about the primary government (the State) and its component units. The statements include a statement of net assets and a statement of activities. These statements report the financial activities of the overall government, except for fiduciary activities. They also distinguish between the governmental and business-type activities of the State and between the State and its discretely presented component units. Governmental activities generally are financed through taxes and intergovernmental revenues. Business-type activities are financed in whole or in part by fees charged to external parties.

The **Statement of Net Assets** presents the State's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

> **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction, or improvement of those assets.
>
> **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions, enabling legislation, or voter initiative.
>
> **Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources, which are imposed by management, but can be removed or modified.

The **Statement of Activities** presents a comparison between direct expenses and program revenues for each function of the State's governmental activities, and its different business-type activities. Direct expenses are those that are specifically associated with a program or function and therefore are clearly identifiable to a particular program or function.

The State does not allocate indirect expenses to programs or functions. Program revenue includes:

- charges to customers or applicants for goods, services, privileges provided and fines or forfeitures,
- operating grants and contributions, and
- capital grants and contributions, including special assessments.

Revenues that are not classified as program revenues, including internally dedicated resources and all taxes, are reported as general revenues.

Generally the effect of interfund activity has been eliminated from the government-wide financial statements to minimize the double counting of internal activities. However, charges for interfund services provided and used are not eliminated.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund financial statements - provide information about the State's funds, including fiduciary funds. Separate statements are presented for the governmental, proprietary, and fiduciary fund categories. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds. Fiduciary funds are aggregated and reported by fund type.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The State reports the following major governmental funds:

The General Fund - is the State's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The Transportation and Aviation Fund - accounts for all financial transactions applicable to the general operations of the Arizona Department of Transportation. The Department builds and maintains the State's highway system and the Grand Canyon airport.

The Land Endowments Fund - holds lands granted to the State by the Federal government for the benefit of public schools and other public institutions. Principal is maintained intact and investment earnings and lease revenues are distributed to beneficiaries in accordance with State statute.

The State reports the following major enterprise funds:

The Universities - account for transactions of the State's three universities, which comprise the State's university system.

The Unemployment Compensation Fund - pays claims for unemployment to eligible recipients from employer contributions and reimbursements.

The Industrial Commission Fund – accounts for deposits not to exceed 1½% of all premiums received by the State Compensation Fund and private insurance carriers during the preceding calendar year. These monies are used to provide additional awards as necessary to enable injured employees to accept the benefits of any law for promotion of vocational rehabilitation of persons disabled in industry.

The Lottery Fund - accounts for the activities of the Arizona State Lottery.

Additionally, the state reports the following fund types:

Internal Service Funds - account for insurance coverage, automotive maintenance and operation, highway equipment rentals, and data processing and telecommunication services provided to State agencies on a cost-reimbursement basis.

Pension Trust Funds - account for the activities of the Arizona State Retirement System, the Public Safety Personnel Retirement System, the Elected Officials' Retirement Plan, and the Correction Officer Retirement Plan, for which the State acts as a trustee. These retirement plans accumulate resources to pay pension benefits of State employees and employees of other governmental entities participating in the plans.

Investment Trust Funds - account for transactions by local governments and political subdivisions that elect to participate in the State Treasurer's investment pools. The Treasurer acts as Trustee for the original deposits made into the investment pools.

Agency Funds - account for the receipt and disbursement of various taxes, deposits, deductions, and property collected by the State, where the State acts as an agent for distribution to other governments and organizations.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

The government-wide, proprietary fund, fiduciary fund and component units financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Grants and donations are recognized as revenues as soon as all eligibility requirements the provider imposed have been met.

Governmental funds in the fund-based financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The State considers all revenues reported in the governmental funds to be available if the revenues are collected within 31 days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they are due and payable. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Under the terms of grant agreements, the State funds certain programs through a combination of grants and general revenues. Therefore, when program expenses are incurred, there are both restricted and unrestricted net assets available to finance the program. The State's policy regarding whether to first apply restricted or unrestricted resources is made on a case-by-case basis.

The State's business-type activities and enterprise funds follow FASB Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements.

D. CASH AND INVESTMENTS

Cash and cash equivalents – cash and cash equivalents include undeposited receipts, petty cash, bank accounts, non-negotiable certificates of deposit, and other highly liquid debt instruments with an original maturity of ninety days or less. Cash and cash equivalents are reported as cash and investments in the accompanying financial statements.

Investments – investments are stated at fair value or amortized cost which approximates fair value, except for mortgages held by the State Compensation Fund, which are stated at amortized cost, and the Treasurer's Custodial Securities of the Agency Funds, which are reported at par value.

E. TAXES RECEIVABLE

Taxes receivable represent amounts owed by taxpayers for the 2001 and prior calendar years including assessments for underpayments, penalties and interest. In the government-wide financial statements, a corresponding amount is recorded as revenue using the accrual basis of accounting. In the governmental fund financial statements, revenue is recorded using the modified accrual basis of accounting. The remainder is recorded as deferred revenues.

The income tax receivable is composed of individual and corporate estimated payments, withholding payments, and payments with final returns and assessments that relate to income earned through June 30, 2002. Sales and motor vehicle and fuel tax receivable represent amounts that are earned by the State in the fiscal period ended June 30, 2002, but not collected until the following month.

F. INVENTORIES

Inventories consist of expendable supplies held for consumption in all funds and merchandise intended for sale to customers in the Proprietary Funds and Universities. Inventories are stated at cost using the first-in, first-out method. In the Governmental Funds, inventories are accounted for using the consumption method. Under this method, inventories are recorded as expenditures as they are used.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. PROPERTY TAX CALENDAR

Real property taxes are levied on or before the third Monday in August and become due and payable in two equal installments. The first installment is due on the first day of October and becomes delinquent after the first business day of November. The second installment is due on the first day of March of the next year and becomes delinquent after the first business day of May. A lien attaches on the first day of January preceding assessment and levy.

H. CAPITAL ASSETS

Capital assets are stated at cost at the date of acquisition or, if donated, at the estimated fair market value at the date received. Interest incurred during the construction of capital assets is only capitalized in the proprietary funds.

Infrastructure, such as roads and bridges, is capitalized for the first time in fiscal year 2001-2002. Most capital assets are depreciated over their useful lives using the straight-line depreciation method. However, infrastructure assets constructed and maintained by the Arizona Department of Transportation will utilize an alternative accounting treatment in which costs to maintain and preserve these assets are expensed and no depreciation expense is recorded. This approach is discussed further in the Required Supplementary Information portion of this report.

Depreciable capital assets are depreciated on a straight-line basis. Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts) and estimated useful lives of capital assets being depreciated in the government-wide financial statements and the proprietary funds are as follows.

	General State Policy		Other Authorized Agency Policies	
Asset Category	Capitalization Threshold	Estimated Useful Life (yrs)	Capitalization Threshold	Estimated Useful Life (yrs)
Land	All capitalized	Not depreciated	All capitalized	Not depreciated
Buildings	All capitalized	25-40	5,000-100,000	5-50
Improvements other than buildings	5,000	15	5,000	1-40
Equipment	5,000	3-15	0-5,000	3-25
Infrastructure	All capitalized	Not depreciated	5,000-100,000	10-100

The State is trustee for approximately 9.3 million acres of land acquired through U.S. Government land grants in the early 1900's. The State acquired a substantial portion of this land at no cost and its fair market value has not been reliably estimated. Accordingly, this land is not reported in the accompanying financial statements. A portion of the land that the State is trustee for has been sold and the buyers of the land have defaulted on the loans. The value of this land has been recorded at the sales price and properly included in the financial statements.

The State has interest in, and maintains significant special collections, works of art, and historical treasures. All special collections, works of art, and historical treasures which are held for financial gain, are capitalized at fair market value at the date of acquisition or donation. Those special collections, works of art, and historical treasures which are held for educational, research, or public exhibition purposes are not capitalized, as they are not subject to disposal for financial gain or encumbrance. Such items are inventoried for property control purposes.

Additional disclosures related to capital assets and assets acquired through capital leases are provided in Notes 4 and 6, respectively.

I. INVESTMENT INCOME

Investment income is composed of interest, dividends, and net changes in fair value of applicable investments.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. SCHOLARSHIP ALLOWANCES

Student tuition and fee revenues, and certain other revenues earned by the three State Universities are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in fund net assets. A scholarship discount and allowance is the difference between the stated charge for goods and services provided and the amount that is paid by the student or third party making payment on behalf of the student. Accordingly, some types of student financial aid such as Pell grants and scholarships awarded by the Universities are considered to be scholarship allowances. These allowances are netted against applicable revenues in the statement of revenues, expenses, and changes in fund net assets.

K. DEFERRED REVENUE

Deferred revenue consists of payments to the State for goods and services, not yet rendered, or taxes, grants, and other non-exchange transactions for which related resources are not available to pay current liabilities. In the government-wide and proprietary fund financial statements revenue is deferred when cash, receivables, or other assets are received prior to their being earned. In the governmental fund financial statements revenue is deferred when that revenue is unearned or unavailable.

L. COMPENSATED ABSENCES

In the government-wide and proprietary fund financial statements, the State accrues liabilities for compensated absences as required by GASB. In the governmental fund financial statements, liabilities for compensated absences are not accrued, because they are not considered “due and payable”.

In general, State employees accrue vested annual leave at a variable rate based on years of service. Except for University employees, an employee forfeits accumulated annual leave in excess of 240 hours at the end of a calendar year, unless the Director of the Department of Administration authorizes an exception. University employees may accumulate up to 264 hours of vacation, and any vacation hours in excess of the maximum amount that are unused at December 31 are forfeited. Except for University employees, an employee who separates from State service is paid for all unused and unforfeited annual leave at the employee’s rate of pay at the time of separation. University employees, upon termination of employment, are paid all unused vacation benefits not exceeding 176 hours (annual accrual amount), depending on years of service and full-time equivalent employment status.

Some employees accumulate compensatory leave for time worked over 40 hours per week. Compensatory leave is treated like annual leave except that the employee must use any compensatory leave before using annual leave.

Sick leave includes any approved period of paid absence granted an employee due to illness, injury or disability. Most State employees accrue sick leave at the rate of eight hours per month without an accumulation limit. Because sick leave benefits do not vest with employees, a liability for sick leave is not accrued in the financial statements. However, State employees are eligible to receive payment for an accumulated sick leave balance of 500 hours or more, with a maximum of 1500 hours, upon retirement directly from State service (See Note 12.C)

M. LONG-TERM OBLIGATIONS

In the government-wide and proprietary fund financial statements, long-term debt and long-term liabilities are reported as liabilities. Amounts due within one year are reported as current liabilities, and amounts due thereafter are reported as non-current liabilities. Premiums and discounts on revenue bonds and certificates of participation are deferred and amortized over the life of the debt instrument using the straight-line method. Bonds and certificates of participation are reported net of the applicable premium or discount. Bond issuance costs are immaterial and are charged to expense in the period incurred.

In the fund financial statements, governmental fund types recognize proceeds from revenue bonds, certificates of participation, and premiums and discounts on revenue bonds and certificates of participation as other financing sources and uses in the current period. Long-term liabilities are more fully described in Note 6.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

N. STATE COMPENSATION FUND

Significant accounting policies relating to the State Compensation Fund include:

1. Policyholders' Dividends

The Board of Directors of the State Compensation Fund makes provisions for dividends to policyholders based on the Fund's overall experience. Dividends are paid to policyholders that meet premium volume and loss experience criteria established by the Board. Dividends of $50.0 million were declared as of December 31, 2001.

2. Reinsurance

The State Compensation Fund is assigned certain policyholders that participate in the National Council on Compensation Insurance (NCCI) assigned risk pool. All premiums collected on such policies are ceded to NCCI. All losses incurred by the Fund on such policies are recoverable from NCCI. In addition, the Fund is assigned a pro rata allocation of the liability for loss and loss expenses incurred by all NCCI policyholders in the State. Losses of other policyholders in excess of specified amounts are recoverable from other reinsurers. Contracts with these reinsurers do not relieve the Fund of its obligation to policyholders.

NOTE 2. CASH AND INVESTMENTS

A. CASH AND INVESTMENT POLICIES

Cash and cash equivalents are under the control of the State Treasurer, the retirement systems or other administrative bodies. Arizona Revised Statutes §35-312, §35-313 and §35-314 authorize the Treasurer to invest operating, trust and permanent endowment fund monies. Therefore, surplus cash deposited with the State Treasurer by State agencies with a statutory authorization to invest and all General Fund monies are invested by the Treasurer in a pooled fund. Any interest earned is allocated monthly into each respective fund based on average daily cash balances. There is no income from investments associated with one fund that is assigned to another fund.

The State Treasurer invests in short-term securities and other investments. Provisions of Arizona law restrict these investments to obligations of the U.S. Government and its agencies, obligations of the State and certain local government subdivisions, interest-bearing savings accounts and certificates of deposit, collateralized repurchase agreements, certain obligations of U.S. corporations, and certain other securities.

The State Treasurer also invests in various mortgage-backed securities for seventeen of the twenty-two investment pools it manages. These securities are reported at fair value on the Statement of Fiduciary Net Assets. In addition, they are reported in aggregate, as U.S. Government securities. The securities are purchased to diversify the State's exposure to maturity and credit risks while providing for enhanced yields. The credit risk associated with holding these securities is reduced since all securities are rated AAA by Standard and Poor's and/or Moody's rating service. The market risk associated with holding these securities is linked to maturity risk in that as interest rates rise, the fair value of these securities will fall and prepayment of principal balances will decelerate. When interest rates fall, the fair value of these securities will rise and prepayment of principal balances will accelerate. The mortgage-backed securities are authorized under ARS §35-313.

Statutes enacted by the Legislature authorize the retirement systems to make investments in accordance with the "Prudent Person" rule. This rule imposes the responsibility of making investments with the judgment and care that persons of ordinary prudence would exercise in the management of their own affairs when considering both the probable safety of their capital and the probable income from that capital. Within this broad framework, the retirement systems have chosen to invest in short-term securities and repurchase agreements, obligations of the U.S. Government and its agencies, corporate bonds, common and preferred stocks and mortgages. The Statutes also place certain restrictions on the investment fund portfolios of the retirement systems.

Investments maintained by the State Treasurer are reported at fair value based upon an independent outside pricing service. Investments with a maturity of 91 days or more and all investments with a maturity of 90 days or less that were held at the beginning of the current fiscal year end, not valued by the pricing service, are valued using a market price solicited from the selling broker or a second outside pricing service. All investments with a remaining maturity of 90 days or less, that have no

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

available market price, and were not held at the beginning of the current fiscal year, are valued using amortized cost. If different amortized cost values exist, the weighted average amortized cost is given to like investments.

The State Treasurer also maintains external investment pools [(the Local Government Investment Pool (LGIP) and Local Government Investment Pool-Government)] with no regulatory oversight. The pools are not required to register (and are not registered) with the Securities and Exchange Commission under the 1940 Investment Advisors Act. The activity and performance of the pools are reviewed monthly by the State Board of Investment in accordance with ARS §35-311. The fair value of investments is measured on a monthly basis. Participant shares are purchased and sold based on the Net Asset Value (NAV) of the shares. The NAV is determined by dividing the fair value of the portfolio by the total shares outstanding. The State Treasurer does not contract with an outside insurer in order to guarantee the value of the portfolio or the price of shares redeemed. Before the end of the fiscal year, the Central Arizona Water Conservation District (CAWCD) transferred all of their money from Pool 3 (State Agencies Investment Pool) to Pool 5 (LGIP). CAWCD was the only external reporting entity that was invested in Pool 3. As a result of this transfer, there are no "external" balances at year-end in Pool 3.

The State Treasurer makes investments only in external investment pools that are registered with the Securities and Exchange Commission. The State Treasurer is not an involuntary participant in another entity's external investment pool.

The State Treasurer is not aware of any involuntary participation of local governments in the State's external investment pools. Participants meeting the criteria established under ARS §35-316 are eligible to participate in the pools and are not required to disclose the reason for requesting the account.

The investments of the State Treasurer's Custodial Securities, an Agency Fund, are recorded at par value. The investments are held by the State Treasurer for state agencies that perform a business compliance function. The investments of the Arizona Exposition and State Fair are reported at the fair value.

The Arizona State Retirement System investments are reported at fair value and cost. Investments, other than real estate and commercial mortgages, are reported at fair values determined by the custodial agents. The agent's determination of fair values includes, among other things, using pricing services or prices quoted by independent brokers at current exchange rates. Commercial mortgages have been valued on an amortized cost basis, which approximates fair value. Short-term investments are reported at cost plus accrued interest which approximates fair value. For investments where no readily ascertainable fair value exists, management, in consultation with its investment advisors, has determined the fair values for the individual investments based on anticipated maturity dates and current interest rates commensurate with the investment's degree of risk.

The Public Safety Personnel, Elected Officials' and Corrections Officer Retirement Systems investments are reported at fair value and cost. Fair values are determined as follows: Short-term investments are reported at fair value, which approximates cost. Equity securities are valued at the last reported sales price. Fixed-income securities are valued using the last reported sales price or the estimated fair market value as determined by an outside pricing service. Investments that do not have an established market are reported at estimated fair value.

The investments of the Universities are reported at fair value. Fair value is determined from quoted market prices. Non-participating interest bearing contracts are valued at cost.

The University Medical Center's short-term investments are reported at cost, which approximates fair value. Long-term investments are reported at fair value as determined by quoted market prices.

The investments of the Arizona Power Authority are reported at amortized cost, which approximates fair value.

The investments of the Water Infrastructure Finance Authority in Guaranteed Investment Contracts are stated at cost, since they are non-participating contracts. The other investments are stated at fair value, which approximates cost.

The investments of the State Compensation Fund in bonds, certificates of participation and equity securities are reported at fair value. Investments in mortgages are reported at amortized cost.

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

B. UNEMPLOYMENT COMPENSATION

ARS §23-703 requires that unemployment compensation contributions from Arizona employers be deposited in an unemployment trust fund account with the Secretary of the Treasury of the United States that is established and maintained pursuant to Section 1104 of the Social Security Act. The cash on deposit in the trust fund account is pooled and invested. Interest earned from investments purchased with such pooled monies is deposited in the trust fund account. The Unemployment Compensation Fund, reported as a major proprietary fund, has been established for this purpose.

C. COLLATERAL AND INSURANCE

The State requires that deposits and investments with financial institutions be entirely covered by Federal depository insurance or, alternatively, collateralized with surety equal to at least 100% (102% for the Treasurer) of the deposits so collateralized. Cash deposited with banks is collateralized based on bank balances. Surety collateralized includes U.S. Government obligations, State obligations, obligations of counties and municipalities within the State, and certain other securities.

D. DEPOSITS COLLATERALIZATION

At June 30, 2002, the carrying amount of the State's deposits for the Primary Government was $114.809 million, $82.651million for Fiduciary funds, and $6.669 million for the Component Units. At June 30, 2002, the bank balance was $188.176 million for the Primary Government, $83.573 million for Fiduciary funds, and $6.669 million for the Component Units. For the Primary Government bank balances, $945 thousand was collateralized by Federal depository insurance. Of the remaining balance, $173.124 million was collateralized by securities held by the bank's trust division or agent in the State's name in book-entry form, and $14.107 million was either not collateralized or was collateralized with securities held in the bank's custodial account with the Federal Reserve in the bank's name in book-entry form. For the Fiduciary funds, $8.923 million was collateralized by Federal depository insurance. Of the remaining balance, $35.507 million was collateralized by securities held by the bank's trust division or agent in the State's name in book-entry form, and $39.143 million was either not collateralized or was collateralized with securities held in the bank's custodial account with the Federal Reserve in the bank's name in book-entry form. For the Component Units bank balances, $6.669 million was either not collateralized or was collateralized with securities held in the bank's custodial account with the Federal Reserve in the bank's name in book-entry form.

E. INVESTMENTS CUSTODIAL RISK

The following tables summarize the credit risk of the State's investments (expressed in thousands). Category A includes investments that are insured or registered, or for which securities are held by the State or the State's agent in the State's name. Category B includes uninsured and unregistered investments for which securities are held by the counterparty's agent or trust department in the State's name. Category C includes uninsured and unregistered investments for which securities are held by the counterparty, or by its agent or trust department but not in the State's name.

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Primary Government

Type of Deposit or Investment	Category A	Category B	Category C	Reported Amount
U.S. Government securities	$ 1,182,262	$ 14,746	$ 199,569	$ 1,396,577
Repurchase agreements	332,503	-	-	332,503
Corporate stocks	461,705	-	-	461,705
Corporate debt	2,045,143	-	-	2,045,143
State and local government securities	171,495	-	-	171,495
Other investments	7,687	-	112,658	120,345
Subtotal	$ 4,200,795	$ 14,746	$ 312,227	4,527,768
Investments Not Subject to Custodial Risk:				
Guaranteed Investment Contracts				7,396
Money Market Mutual Funds				204,588
Mutual Funds-Benchmark Portfolio				8,482
Mortgages				1,190
Joint Venture				14,000
Collateral Investment Pool				134,945
Investments held by brokers/dealers under Security Loan Program:				
U.S. Government securities				95,469
Corporate stocks				22,146
Corporate debt				14,854
United States Treasury Pooled Investment				1,033,276
Repurchase agreements				7,631
Total Investments				6,071,745
Deposits				114,809
Total Cash and Investments				$ 6,186,554

Fiduciary Funds

Type of Deposit or Investment	Category A	Category B	Category C	Reported Amount
US Government Securities	$ 5,223,420	$ -	$ -	$ 5,223,420
Corporate stocks	12,111,038	2,873,498	-	14,984,536
Corporate debt	5,895,812	-	-	5,895,812
State and local government securities	489,866	-	-	489,866
Repurchase agreements	18,790	-	-	18,790
Other investments	164,396	18,752	449	183,597
Subtotal	$ 23,903,322	$ 2,892,250	$ 449	26,796,021
Investments Not Subject to Custodial Risk:				
Other investment-not categorized				228,900
Short-Term Investment Fund				2,285,988
Real estate				30,213
Collateral Investment Pool				1,281,416
Investments held by brokers/dealers under Security loan program:				
U.S. Government securities				1,778,217
Corporate stocks				837,930
Corporate debt				370,606
Repurchase agreements				9,395
Total Investments				33,618,686
Deposits				82,651
Total Cash and Investments				$ 33,701,337

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Component Units

Type of Deposit or Investment	Category A	Category B	Category C	Reported Amount
U.S. Government securities	$ 802,195	$ -	$ 2,695	$ 804,890
Corporate stocks	171,606	15,230	-	186,836
Corporate debt	775,192	1,198	-	776,390
State and local government securities	238,893	1,722	-	240,615
Repurchase agreements	11,017	-	-	11,017
Other investments	652	37,916	76,746	115,314
Subtotal	$ 1,999,555	$ 56,066	$ 79,441	2,135,062
Investments Not Subject to Custodial Risk:				
Mortgages				150,725
Guaranteed Investment Contract				77,680
Collateral Investment Pool				193,027
Investments held by brokers/dealers				
Under Security Loan Program:				
U.S. Government securities				162,373
Corporate stocks				27,359
Repurchase agreements				232
Total Investments				2,746,458
Deposits				6,669
Total Cash and Investments				$ 2,753,127

At June 30, 2002, the State had no commitments to resell securities under yield maintenance agreements.

During the year ended June 30, 2002, the State did not make significant investments in types of investments beyond those enumerated in the preceding tables.

F. SECURITIES LENDING

Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. A corresponding liability is also recorded for such securities lending transactions.

1. State Treasurer

The State Treasurer (Treasurer) is permitted by Title 35, Chapter 2, Article 2 of the Arizona Revised Statutes to enter into securities lending transactions. The custodial bank, Credit Suisse First Boston (CSFB), manages the securities lending transactions through a contractual agreement with the Treasurer. CSFB enters into securities lending contracts only from an approved list of borrowers provided by the Treasurer. There was no credit risk (i.e., lender's exposure to the borrowers of its securities related to the securities lending transactions at June 30, 2002). As of June 30, 2002, the amounts owed by the Treasurer exceeded the amounts owed by the borrowers. During the fiscal year ended June 30, 2002, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses to the securities lending agent. U.S. Government bonds and domestic equities are loaned for cash as collateral and there are no restrictions on the amount of loans that can be made. The treasurer requires at least 102% of the market value of the loaned securities on the date of the loan, and no less than 100% for the duration of the loan. The Treasurer does not have the ability to pledge or sell collateral securities unless the borrower defaults. Additionally, CSFB provides indemnification to the extent of borrower default. The fair value at June 30, 2002, for loaned securities collateralized by cash was $17.17 million. As part of the securities lending transactions, CSFB received cash collateral valued at $17.96 million. Investments are held by CSFB in the Treasurer's name.

The maturities of investments match the maturities of securities on loan. On June 30, 2002, both the cash collateral reinvestment and the term of all loans outstanding were one day. During the same period, there were no losses on securities lending transactions resulting from borrower or lending agent default. Investments made with cash collateral received are classified as an asset at fair value on the Statement of Fiduciary Net Assets. A corresponding liability is recorded as the Treasurer must return the

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

cash collateral to the borrower upon expiration of the loan. At June 30, 2002, the Treasurer had $17.96 million outstanding as payable for securities lending.

2. Industrial Commission

State statutes and Industrial Commission (the Commission) policies permit the Commission to enter into securities lending transactions with its custodial bank. There were no significant violations of legal or contractual provisions, and there were no borrower or lending agent default losses to the securities lending agent. The custodial bank, Northern Trust, manages the securities lending operations through a contractual agreement with the Commission and splits the fees received with the Commission. There was no credit risk (i.e. lender's exposure to the borrowers of its securities) related to the securities lending transactions at June 30, 2002. Northern Trust's indemnification responsibilities include performing appropriate borrower and collateral investment credit analysis, demanding adequate types and levels of collateral, and complying with applicable Department of Labor and Federal Financial Institutions Examinations Council regulations concerning securities lending. Securities are loaned for collateral that may include cash, U.S. Government securities and irrevocable letters of credit. Domestic securities are loaned for collateral valued at 102% of the market value of securities loaned plus accrued interest. International securities are loaned for collateral valued at 105% of the market value of securities loaned plus accrued interest. The market value at June 30, 2002 for loaned securities collateralized by cash and non-cash collateral was $32.352 million and $3.599 million, respectively. As part of the securities lending transactions, Northern Trust received cash and non-cash collateral valued at $33.215 million and $3.681 million, respectively at June 30, 2002. Non-cash collateral cannot be pledged or sold unless the borrower defaults. Securities lent at year-end for cash collateral are presented as unclassified in the preceding schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the collateral received on the securities lent.

All securities loans can be terminated on demand by either the lender or the borrower. The average terms of the loans are 97 days and cash open collateral is invested in a short-term investment pool, the Core USA Collateral Section, which had an average weighted maturity of 30 days as of June 30, 2002. Cash collateral may also be invested separately in "term loans", in which case the investments match the loan term. Cash open loans can be terminated on demand by either lender or borrower and there were no dividends or coupon payments owing on securities lent. Securities lending earnings are credited to participating clients on approximately the fifteenth day of the following month. Investments made with cash collateral received are classified as an asset on the Statement of Net Assets. A corresponding liability is recorded as the Commission must return the cash collateral to the borrower upon expiration of the loan. At June 30, 2002, the Commission had $33.215 million outstanding as payable for securities lending.

3. Arizona State Retirement System

The Arizona State Retirement System (ASRS) is permitted by Arizona Revised Statutes §38-715(D)(3), to enter into securities lending transactions. The ASRS enters into agreements with brokers to loan securities and have the same securities redelivered at a later date. All securities are eligible for loan (U.S. fixed income securities, U.S equities, international equities) with a higher percentage of U.S. Treasuries on loan than most other security types. It is the policy of the ASRS to receive as collateral at least 102% of the market value of the loaned securities and maintain collateral at no less than 100% for the duration of the loan. At year-end, the ASRS has no credit risk exposure to borrowers because the amount the ASRS owes the borrowers exceeds the amount the borrowers owe the ASRS. During fiscal year 1998, statutes were amended to allow for other than cash collateral. The ASRS records the collateral received as an asset and the same amount as an obligation for securities on loan. Any cash collateral received is invested in short-term investments. The ASRS receives a spread for its lending activities. Investments made with cash collateral received are classified as an asset on the Statement of Fiduciary Net Assets. A corresponding liability is recorded as the ASRS must return the cash collateral to the borrower upon expiration of the loan. At June 30, 2002, the ASRS had $1.674 billion outstanding as payable for securities on loan.

Due to the flow of securities to and from transfer agents and the security loan program, securities occasionally cannot be delivered for a sale or received for a purchase, resulting in a "failed" transaction. Securities with trade dates in June and settlement dates in

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

July result in "outstanding" transactions. Since these securities have contractually changed ownership, receivables and payables result from these transactions. Such transactions resulted in a receivable for securities sold of $188.868 million and a payable for securities purchased of $455.270 million at June 30, 2002.

4. Public Safety Personnel Retirement System, Elected Officials' Retirement Plan and Corrections Officer Retirement Plan

The Public Safety Personnel Retirement System (PSPRS), the Elected Officials' Retirement Plan (EORP) and the Corrections Officer Retirement Plan (CORP) are permitted by Title 38, Chapter 5, Articles 3, 4, and 6 of the Arizona Revised Statutes to enter into securities lending transactions. The PSPRS, EORP and CORP are parties to securities lending agreements with a bank. The bank, on behalf of the PSPRS, EORP and CORP, enters into agreements with brokers to loan securities and have the same securities returned at a later date. The loans are fully collateralized, primarily by cash. Collateral is marked-to-market on a daily basis. Non-cash collateral can be sold only upon borrower default. The PSPRS, EORP and CORP require collateral of at least 102% of the fair value of the loaned U.S. Government or corporate security. Securities on loan are carried at fair value. As of June 30, 2002, the fair value of securities on loan were (expressed in millions):

PSPRS	$ 995,802
EORP	81,493
CORP	168,900

The PSPRS, EORP and CORP receive a negotiated fee for their loan activities and are indemnified for broker default by the securities lending agent. The PSPRS, EORP and CORP participate in a collateral investment pool. All security loans can be terminated on demand by either the pool participants or the borrower. All term loans have a matched collateral investment. The total cash collateral received for unmatched loans (any loan for which the cash collateral has not been invested for a specific maturity) will have a maximum average maturity, using the reset date as the maturity date, of not more than 45 days. And, at least 20% of total collateral investments must be invested on an overnight basis and at least 30% of total collateral investments must be invested with a maturity of 7 days or less. Additionally, no more than 20% of the total collateral investments will be invested in instruments maturing in over 91 days. In lending securities, investments of cash collateral for open loans as of June 30, 2002 are not matched in maturity and have a weighted average maturity of 17 days. The Systems have no credit risk because the amounts owed to borrowers exceed the amounts borrowers owe to the Systems. Under this program, the Systems have not experienced any defaults or losses on these loans.

5. State Compensation Fund

The State Compensation Fund (the Fund) participates in a securities lending program in which securities are loaned to approved brokers/dealers for specified periods of time. All securities on loan are collateralized by cash or cash equivalents of at least 102% of their fair market value. The collateral is maintained by the Fund's investment trustee who is not a party to the security lending agreement. The Fund has invested securities on loan with a market value of approximately $189.732 million and a book value of $175.350 million at December 31, 2001. The collateral held and the corresponding obligation for its return have been recorded in short-term investments and liabilities, respectively.

6. University of Arizona

During the fiscal year, the University engaged in securities lending transactions. The University entered into an agreement with Wells Fargo, the University's custodian, to carry out these transactions. The custodian enters into agreements with brokers to loan securities and have the same securities returned at a later date. It is the policy of the University to receive as collateral at least 102% of the market value of the loaned securities and accrued interest, and maintain collateral at no less than 100% for the duration of the loan. At year-end, the University has no credit risk to borrowers because the University was holding more collateral than the amount of loaned securities outstanding.

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

The University records the collateral received as an asset, which is offset by an obligation recorded under securities lending. During the fiscal year ended June 30, 2002, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses. Wells Fargo does not indemnify the University to the extent of borrower defaults. Collateral can be received in the form of U.S. Government securities, letters of credit, or cash. As of June 30, 2002, the custodian has received only cash and letter of credit collateral. Cash collateral received from the borrowers is invested in a short-term cash collateral investment pool, which, on average, has a weighted maturity of 55 days. The relationship between the maturities of the cash collateral investment pool and the University's loans is affected by the maturities of the securities loans made by other entities that use the custodian's pool, which the University cannot determine. This pool consists of investments in domestic and foreign bank obligations, commercial paper and participations, mortgage backed and pass-through securities, corporate notes, bonds, debentures, and tri-party repurchase agreements. At June 30, 2002, cash collateral investments totaled $101.730 million with a corresponding market value of securities on loan of $100.117 million. Securities lent for cash collateral included corporate stocks, corporate bonds, government notes, and government bonds. The University or the borrower can terminate all securities loans on demand. The University cannot sell or pledge securities received as collateral unless the borrower defaults. The University earns a negotiated fee for participating in loan activities.

G. DERIVATIVES

Derivatives are financial instruments (securities or contracts) whose value is dependent on reference rates or indices such as stock or bond prices, interest rates or currency exchange rates. ASRS internal investment managers use derivatives to hedge currency risk, reduce transaction costs, obtain market exposure, and enhance returns.

The principal categories of derivatives employed and their uses during the year were as follows:

Category	Purpose
Foreign exchange forward contracts	Hedge currency risk of investment denominated in foreign currencies.
Futures	Reduce transaction costs; obtain market exposure; enhance returns.
SWAPS	Interest rate risk management; enhance returns.

Generally, derivatives are subject to both market risk and counterparty risk. The derivatives utilized by ASRS internal investment managers typically have no greater market risk than their physical counterparts, and in many cases are offset by exposure elsewhere in the portfolio.

The ASRS believes that it is unlikely that any of the derivatives used by its internal investment managers could have a material adverse effect on the financial conditions of the System.

H. CUSTODIAL SECURITIES

In accordance with Arizona Revised Statutes, various State agencies deposit securities with the Treasurer for safekeeping. The State agencies have securities in safekeeping with the Treasurer in the form of U.S. government and agency securities, certificates of deposit, municipal and corporate bonds, and surety bonds at June 30, 2002.

NOTE 2. CASH AND INVESTMENTS (CONCLUDED)

I. STATE TREASURER'S SEPARATELY ISSUED FINANCIAL STATEMENTS

The State Treasurer issues a separately published Annual Financial Report. The report provides additional information relating to the State Treasurer's total investing activities and the internal and external participants of the Investment Trust Funds. The Investment Trust Funds report on the activities of the Local Government Investment Pools and Central Arizona Water Conservation District Investment Account. A copy of the State Treasurer's Office Annual Financial Report can be obtained from their office at:

State Treasurer's Office
1700 W. Washington
Phoenix, Arizona 85007-2812

The Treasurer's financial statements are audited by the Office of the Auditor General.

J. AUDITED FINANCIAL STATEMENTS

The four State pension plans and certain State agencies, commissions and authorities are audited by independent public accountants. Copies of these audits, as well as audits performed by the State Auditor General, are available from the State Library, Archives and Public Records.

NOTE 3. RECEIVABLES/DEFERRED REVENUE

A. TAXES RECEIVABLE

The following table summarizes taxes receivable at June 30, 2002 (expressed in thousands). These amounts include $99.766 million for underpayments, penalties, and interest:

Type of Tax	General Fund	Transportation & Aviation Fund	Unemployment Compensation Fund	Non-Major Funds	Government Wide Total
Sales	$ 245,851	$ -	$ -	$ 1,375	$ 247,226
Income – individual and corporate	221,598	-	-	-	221,598
Insurance premium	28,790	-	-	-	28,790
Motor vehicle and fuel	-	102,619	-	-	102,619
Luxury	5,074	-	-	4,959	10,033
Unemployment	-	-	38,069	-	38,069
Gross taxes receivable	501,313	102,619	38,069	6,334	648,335
Allowance for uncollectible taxes	(107,475)	-	-	-	(107,475)
Net Taxes Receivable	$ 393,838	$ 102,619	$ 38,069	$ 6,334	$ 540,860

NOTE 3. RECEIVABLES/DEFERRED REVENUE (CONCLUDED)

B. DEFERRED REVENUE

At June 30, 2002, the components of deferred revenue, in terms of revenue unavailable and unearned, were as follows (expressed in thousands):

	Unavailable	Unearned	Total Deferred Revenue
Current Deferred Revenue for Governmental Funds:			
General Fund:			
Delinquent sales tax	$ 46,755	$ -	$ 46,755
Delinquent income tax	58,188	-	58,188
Advance insurance premiums	-	1,468	1,468
Advance land lease payments	-	7,460	7,460
Food stamps	-	100	100
Vaccine & commodity food supplement	-	7,023	7,023
Transportation and Aviation Fund:			
Notes receivable for real estate mortgage loans	11,571	-	11,571
Land Endowments Fund:			
Land sales receivable	213,186	-	213,186
Advance land sales payments	-	1,430	1,430
Advance land lease payments	-	1,198	1,198
Non-Major Funds:			
Public assistance overpayments	1,646	-	1,646
Other	-	564	564
Total current deferred revenue for governmental funds	331,346	19,243	350,589
Non-current Deferred Revenue for Governmental Funds			
Land Endowments Fund:			
Advance land lease payments	-	9,822	9,822
Total current and non-current deferred revenue for governmental funds	$ 331,346	$ 29,065	$ 360,411

	Unearned
Current Deferred Revenue for Proprietary Funds:	
Universities:	
Unexpended cash advances received for sponsored programs	$ 35,600
Auxiliary sales and services	6,262
IBM lease related to acquisition of research park	4,900
Student tuition and fees	36,533
Other deferred revenue	830
Deposits	1,517
Non-Major Funds:	
Policyholders' advance premiums	2,841
Magazine subscriptions	4,411
Total current deferred revenue for proprietary funds	$ 92,894
Non-current Deferred Revenue for Proprietary Funds:	
Universities:	
IBM lease related to acquisition of research park	$ 54,371
Total non-current deferred revenue for proprietary funds	$ 54,371
Current Deferred Revenue for Component Units:	
State Compensation Fund:	
Policyholders' advance premiums	$ 44,505
Water Infrastructure Finance Authority:	
Unearned loan revenue	1,509
Total current deferred revenue for component units	$ 46,014

NOTE 4. CAPITAL ASSETS

Capital asset activities for the fiscal year ended June 30, 2002 were as follows (expressed in thousands):

	Primary Government				
	Beginning Balance	**Additions**	**Retirements**	**Adjustments & Reclassifications**	**Ending Balance**
Governmental activities:					
Capital assets, not being depreciated:					
Land	$ 1,648,859	$ 665,054	$ (490,709)	$ (8,496)	$ 1,814,708
Construction in progress	1,193,368	830,071	(349,517)	2,597	1,676,519
Infrastructure	7,190,405	280,656	(7,165)	-	7,463,896
Total capital assets, not being depreciated	10,032,632	1,775,781	(847,391)	(5,899)	10,955,123
Capital assets being depreciated:					
Buildings	906,259	26,134	(2,628)	134,172	1,063,937
Improvements other than buildings	112,071	2,676	(10,165)	11,255	115,837
Equipment	517,941	51,566	(35,330)	51,884	586,061
Infrastructure	-	4,643	-	-	4,643
Total capital assets, being depreciated	1,536,271	85,019	(48,123)	197,311	1,770,478
Less accumulated depreciation for:					
Buildings	(261,638)	(27,222)	243	(38,498)	(327,115)
Improvements other than buildings	(46,430)	(12,368)	-	7,292	(51,506)
Equipment	(347,637)	(64,783)	21,719	(13,644)	(404,345)
Infrastructure	(1,414)	(102)	-	-	(1,516)
Total accumulated depreciation	(657,119)	(104,475)	21,962	(44,850)	(784,482)
Total capital assets, being depreciated, net	879,152	(19,456)	(26,161)	152,461	985,996
Governmental activities capital assets, net	$ 10,911,784	$ 1,756,325	$ (873,552)	$ 146,562	$ 11,941,119

	Beginning Balance	**Additions**	**Retirements**	**Adjustments & Reclassifications**	**Ending Balance**
Business-type activities:					
Capital assets, not being depreciated:					
Land	$ 137,191	$ 780	$ (520)	$ (3,928)	$ 133,523
Construction in progress	126,414	91,221	(119,063)	-	98,572
Collections	15,791	1,049	(4,542)	-	12,298
Total capital assets, not being depreciated	279,396	93,050	(124,125)	(3,928)	244,393
Capital assets being depreciated:					
Buildings	1,982,264	147,763	(29,233)	(12)	2,100,782
Improvements other than buildings	36,354	784	-	(218)	36,920
Equipment	1,032,550	127,884	(21,652)	(2,671)	1,136,111
Infrastructure	151,931	58,359	-	3,011	213,301
Total capital assets, being depreciated	3,203,099	334,790	(50,885)	110	3,487,114
Less accumulated depreciation for:					
Buildings	(760,603)	(60,462)	9,837	6,232	(804,996)
Improvements other than buildings	(16,867)	(1,206)	-	-	(18,073)
Equipment	(690,601)	(82,633)	29,898	961	(742,375)
Infrastructure	(57,547)	(9,156)	-	(6,597)	(73,300)
Total accumulated depreciation	(1,525,618)	(153,457)	39,735	596	(1,638,744)
Total capital assets, being depreciated, net	1,677,481	181,333	(11,150)	706	1,848,370
Business-type activities capital assets, net	$ 1,956,877	$ 274,383	$ (135,275)	$ (3,222)	$ 2,092,763

NOTE 4. CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to governmental functions as follows (expressed in thousands):

General government	$	21,874
Health & welfare		15,531
Inspection & regulation		2,240
Education		1,050
Protection & safety		29,829
Transportation		15,784
Natural resources		18,167
Total governmental activities	$	104,475

Depreciation expense was charged to business-type activities as follows (expressed in thousands):

Arizona Lottery	$	305
Industrial Commission		714
Universities		149,493
Non-major Funds		2,945
Total business-type activities	$	153,457

Discretely presented component units capital asset activities for the fiscal year ended June 30, 2002 were as follows (expressed in thousands):

	Component Units			
	Beginning Balance	**Additions**	**Retirements**	**Ending Balance**
Component Units:				
Capital assets, not being depreciated:				
Land	$ 9,558	$ 194	$ (43)	$ 9,709
Construction in progress	4,381	6,561	(5,799)	5,143
Total capital assets, not being depreciated	13,939	6,755	(5,842)	14,852
Capital assets being depreciated:				
Buildings	176,038	2,209	(197)	178,050
Improvements other than buildings	6,108	1,666	(1,393)	6,381
Equipment	138,287	8,233	(932)	145,588
Total capital assets, being depreciated	320,433	12,108	(2,522)	330,019
Less accumulated depreciation for:				
Buildings	(77,041)	(6,368)	107	(83,302)
Improvements other than buildings	(3,461)	(478)	59	(3,880)
Equipment	(112,868)	(13,226)	1,549	(124,545)
Total accumulated depreciation	(193,370)	(20,072)	1,715	(211,727)
Total capital assets, being depreciated, net	127,063	(7,964)	(807)	118,292
Component Units capital assets, net	$ 141,002	$ (1,209)	$ (6,649)	$ 133,144

NOTE 4. CAPITAL ASSETS (CONCLUDED)

Depreciation expense was charged to component units as follows (expressed in thousands):

University Medical Center	$	17,825
Arizona Power Authority		29
State Compensation Fund		2,218
Total component units	$	20,072

NOTE 5. RETIREMENT PLANS

The State contributes to the four plans described below. The four plans are considered part of the State's financial reporting entity and are included in the State's financial statements as Pension Trust Funds.

A. PLAN DESCRIPTIONS

The State participates in the Arizona State Retirement System (ASRS), the Public Safety Personnel Retirement System (PSPRS), the Elected Officials' Retirement Plan (EORP) and the Corrections Officer Retirement Plan (CORP). Benefits are established by state statutes and provide retirement, death, long-term disability, survivor and health insurance premium benefits to State employees, public school employees and employees of counties, municipalities and certain other State political subdivisions.

The **ASRS** is a cost-sharing, multiple-employer defined benefit pension plan that benefits employees of the State, its political subdivisions and public schools. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of ARS Title 38, Chapter 5, Article 2.

The **PSPRS** is an agent, multiple-employer defined benefit pension plan that benefits fire fighters and police officers employed by the State or certain local governments. The PSPRS, acting as a common investment and administrative agent, is governed by a five-member board, known as the Fund Manager, and 185 local boards according to the provisions of ARS Title 38, Chapter 5, Article 4.

The **EORP** is a cost-sharing, multiple-employer defined benefit pension plan that benefits all elected State and county officials and judges and certain elected city officials. The EORP is governed by the Fund Manager of the PSPRS according to the provisions of ARS Title 38, Chapter 5, Article 3.

The **CORP** is an agent, multiple-employer defined benefit pension plan that benefits town, city and county detention officers and certain employees of the Arizona Department of Corrections and the Arizona Department of Juvenile Corrections. The CORP is governed by the Fund Manager of the PSPRS and 11 local boards according to the provisions of ARS Title 38, Chapter 5, Article 6.

Each plan issues a publicly available financial report that includes its financial statements and required supplementary information. A report may be obtained by writing or calling the applicable plan.

Arizona State Retirement System
3300 North Central Avenue
P.O. Box 33910
Phoenix, Arizona 85067-3910
(602) 240-2000 or (800) 621-3778

Public Safety Personnel Retirement System, Elected Officials' Retirement Plan or the Corrections Officer Retirement Plan
1020 East Missouri Avenue
Phoenix, Arizona 85014
(602) 255-5575

NOTE 5. RETIREMENT PLANS (CONTINUED)

The number of participating government employers as of June 30, 2002, are shown below:

Employer	ASRS	PSPRS	EORP	CORP
Cities and towns	65	118	16	-
Counties and county agencies	14	21	15	10
State	1	1	1	1
Special districts	59	45	-	-
School districts	226	-	-	-
Charter schools	138	-	-	-
Community college districts	10	-	-	-

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As part of the Pension Trust Funds, the financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred and revenues are recorded in the accounting period in which they are earned and become measurable. Employee contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Contributions from employees and employers for service through June 30 are accrued. These contributions are considered to be fully collectible and, accordingly, no allowance for uncollectible receivables is reflected in the financial statements.

For the ASRS, investments are reported at fair value and at cost. Security transactions and any resulting gains or losses are accounted for on a trade-date basis. Investments, other than real estate and commercial mortgages, are reported at fair values determined by the custodial agents. The agent's determination of fair values includes, among other things, using pricing services or prices quoted by independent brokers at current exchange rates. Commercial mortgages have been valued on an amortized cost basis, which approximates fair value. No allowance for loan loss has been provided as all loans and bonds are considered by management to be fully collectible.

Short-term investments are reported at cost, which approximates fair value. For investments where no readily ascertainable fair value exists, management, in consultation with its investment advisors, has determined the fair values for the individual investments based on anticipated maturity dates and current interest rates commensurate with the investment degree of risk. Net investment income includes net decrease in fair value of investments, interest income, dividend income and total investment expense, which includes investment management and custodial fees and all other significant investment related costs.

For the PSPRS, EORP and the CORP, investments are reported at fair value and at cost. Fair values are determined as follows: Short-term investments are reported at fair value, which approximates cost. Equity securities are valued at the last reported sales price. Fixed-income securities are valued using the last reported sales price or the estimated fair market value as determined by one of the world's largest and most prominent fixed-income broker/dealers. Investments that do not have an established market are reported at estimated fair value. Investment income is recognized as earned.

C. INVESTMENT RESTRICTIONS

Statutes enacted by the Arizona State Legislature restrict the four retirement plans from investing more than five percent of each plan's total assets in securities issued by any one institution, agency or corporation, other than securities issued as direct obligations of or fully guaranteed by the U.S. Government. As of June 30, 2002, the four retirement plans are in compliance with the state statutes.

D. FUNDING POLICY

The contribution requirements of plan members and the State are established by Title 38, Chapter 5 of the Arizona Revised Statutes. These contribution requirements may be amended by the Arizona State Legislature.

NOTE 5. RETIREMENT PLANS (CONTINUED)

Cost-sharing plans – For the year ended June 30, 2002, active ASRS members and the State were each required by statute to contribute at the actuarially determined rate of 2.49 percent (2.0 percent retirement and 0.49 percent long-term disability) of the members' annual payroll. The State's contributions to ASRS for the years ended June 30, 2002, 2001 and 2000 were $36.605, $36.832, and $35.147 million, respectively, for the primary government and $565, $298, and $617 thousand, respectively, for the component units, which were equal to the required contributions for the year.

In addition, active EORP members were required by statute to contribute 7.00 percent of the members' annual covered payroll. The State was required to contribute a designated portion of certain fees collected by the Supreme Court plus additional contributions of 6.97 percent of the members' annual covered payroll, as determined by actuarial valuation. The State's contributions to EORP for the years ended June 30, 2002, 2001 and 2000 were $77, $183, and $184 thousand, respectively, which were equal to the required contributions for the year.

Agent plans – For the year ended June 30, 2002, active PSPRS members were required by statute to contribute 7.65 percent of the members' annual covered payroll and the participating State agencies were required to contribute at actuarially determined rates of 3.31 – 16.27 percent. Active CORP members were required by statute to contribute 8.50 percent of the members' annual covered payroll and the participating State agencies were required to contribute at actuarially determined rates of 4.01 - 5.08 percent.

E. ANNUAL PENSION COST

The State's annual pension cost and related actuarial data for each of the agent, multiple-employer defined benefit pension plans for the year ended June 30, 2002, is as follows (expressed in thousands):

	PSPRS	CORP
Contribution rates:		
State	3.31% - 16.27%	4.01% - 5.08%
Plan members	7.65%	8.50%
Annual pension cost	$4,799	$5,775
Contributions made	$4,799	$5,775
Actuarial valuation date	6/30/00	6/30/00
Actuarial cost method	entry age	entry age
Actuarial assumptions:		
Investment rate of return	9%	9%
Projected salary increases	6.5% - 9.5%	6.5% - 9.5%
includes inflation at	5.5%	5.5%
Cost-of-living adjustments	none	none
Amortization method	level percent open	level percent open
Remaining amortization	20 years	20 years
Asset valuation method	4 year smoothed market value	4 year smoothed market value

NOTE 5. RETIREMENT PLANS (CONTINUED)

F. TREND INFORMATION

Information for each of the agent, multiple-employer defined benefit plans as of the most recent actuarial valuations is as follows (expressed in thousands):

Contributions Required and Contributions Made

	Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
PSPRS	6/30/02	$ 4,799	100%	$ 0
	6/30/01	4,510	100%	0
	6/30/00	4,106	100%	0
CORP	6/30/02	5,775	100%	0
	6/30/01	14,209	100%	0
	6/30/00	13,840	100%	0

G. UNIVERSITIES' DEFINED CONTRIBUTION PLANS

Faculty, academic professional and administrative officers at the three universities (Arizona State University, Northern Arizona University, and University of Arizona) may select one of six retirement plans: the Teachers Insurance Annuity Association/College Retirement Equities Fund (TIAA/CREF), Variable Annuity Life Insurance Company (VALIC), Fidelity Investments Tax-Exempt Services Company (Fidelity), Aetna Life Insurance and Annuity Company (Aetna), The Vanguard Group (Vanguard) or the Arizona State Retirement System (ASRS). The ASRS is a defined benefit plan (described above) and the other five plans are defined contribution plans. The five defined contribution plans are administered by independent insurance and annuity companies approved by the Arizona Board of Regents. In addition, University of Arizona employees hired before July 1, 1972, have the option to participate in the defined contribution plan administered by the ASRS. Eligible classified staff belong to the Arizona State Retirement System. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings.

The Arizona State Legislature establishes and may amend active plan members' and the Universities' contribution rates. For the year ended June 30, 2002, plan members and the three Universities were each required by statute to contribute an amount equal to seven percent of an employee's compensation, except for a 7.06 percent contribution for the ASRS plan.

Contributions to these plans for the year ended June 30, 2002, were as follows (expressed in thousands):

Plan	University Contributions	Employee Contributions	Total Contributions
TIAA/CREF	$ 23,015	$ 23,015	$ 46,030
VALIC	2,951	2,951	5,902
Fidelity	3,685	3,685	7,370
Aetna	1,186	1,186	2,372
Vanguard	719	719	1,438
ASRS	161	159	320

NOTE 5. RETIREMENT PLANS (CONCLUDED)

H. UNIVERSITY MEDICAL CENTER DEFINED CONTRIBUTION PLAN

The University Medical Center (UMC) has an Employee Pension Plan (the Plan) for its employees. The Plan is a defined contribution plan covering all UMC employees who are subject to minimum employment requirements, as defined in the Plan Agreement. The UMC makes contributions to the Plan in amounts equal to (a) 5.5 percent of total compensation plus (b) 5.4 percent of compensation in excess of 80 percent of the FICA wage base. Such contributions are allocated to each participant as defined in the Plan Agreement. Retirement plan expense, net of participant forfeitures, was approximately $4.44 million for the year ended June 30, 2002.

I. POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described, the ASRS offers the Retiree Group Insurance Program and the Health Insurance Premium Benefit Program to eligible retired and disabled members. A retired member is defined as a member actively receiving an annuity benefit and a disabled member is defined as a member receiving a Long-Term Disability ("LTD") benefit through the LTD program administered by the ASRS or through their former member employer's group LTD plan.

Pursuant to A.R.S. 38-782, the Retiree Group Insurance Program makes available group health insurance coverage to eligible retired and disabled members and their dependents. Retired and disabled members of the ASRS, the Public Safety Personnel Retirement System, the Elected Officials Retirement Plan, and the Corrections Officer Retirement Plan may participate if they are no longer eligible for health insurance benefits through their former employer. More than 38,000 coverage agreements currently exist for retired and disabled members and their dependents.

Pursuant to A.R.S. 38-783, retired and disabled members with at least five years of credited service are eligible to participate in the Health Insurance Premium Benefit (subsidy) Program. This assistance is provided to those members that elect group coverage through either the Retiree Group Insurance Program or their former member employer. The maximum amount of the monthly available benefit for eligible members and their dependents ranges from $50 to $600. The ASRS reimbursed approximately $76.0 million and $40.5 million towards the cost of group health insurance coverage for the years ended June 30, 2002 and June 30, 2001, respectively.

NOTE 6. LONG-TERM OBLIGATIONS

A. REVENUE BONDS

Governmental Activities

1. Arizona Department of Transportation

The Arizona Department of Transportation (ADOT) issued Senior and Subordinated Highway Revenue Bonds to provide funds for acquisition of right-of-way and construction of federal, state and local highways. The original amount of Highway Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was $700.280 million. During the year, Highway Revenue Bonds totaling $150.240 million were issued to (i) finance portions of the Transportation Board's Five Year Transportation Facilities Construction Program, (ii) pay costs of issuing the Bonds, and (iii) refund in advance of maturity portions of ADOT's outstanding Senior and Subordinated Bonds in the aggregate principal amount of $71 million.

The Highway Revenue Bonds are secured by a prior lien on and a pledge of motor vehicle and related fuel fees and taxes of the General Fund. Arizona Revised Statutes prohibit the total principal amount of Arizona Highway Revenue Bonds, excluding refunded bonds, from exceeding $1.3 billion.

The Maricopa County Regional Area Road Bond Fund is used to record all payments of principal and interest for Transportation Excise Tax Revenue Bonds issued by ADOT. The Bonds are secured by transportation excise taxes collected by the Arizona Department of Revenue on behalf of Maricopa County. The original amount of Transportation Excise Tax Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was $700.335 million. During the year, Transportation Excise Tax Revenue Bonds totaling $66.010 million were issued to (i) finance the acquisition of land and the design and construction of certain controlled access highways within Maricopa County, Arizona and (ii) pay costs of issuing the Bonds.

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

The Bond Resolution adopted by the Transportation Board on July 25, 1986 established a debt service reserve requirement equal to the maximum annual interest due in the current year or future years on any series of outstanding Transportation Excise Tax Revenue Bonds. The Second Supplemental Transaction Exercise Revenue Bond Resolution adopted by the Board on September 22, 1988, gives the Board the option, which it has elected, of acquiring debt service reserve insurance policies in lieu of the debt service reserve requirement. Accordingly, no debt service reserve is reported in the accompanying financial statements. The policies (aggregating $70.064 million at June 30, 2002) were issued by Financial Guaranty Insurance Company, except for the 1993 Series Subordinated Bonds policies, which were issued by MBIA Insurance Corporation, and the 1995 Series A and Series B Subordinated Bonds policies, which were issued by AMBAC Assurance Corporation. These policies are noncancelable and insure payment, up to the policy amount, of the bond interest on their respective payment dates. The policies shall terminate on the earlier of July 1, 2005, or the date when no respective bonds are outstanding under the bond resolution. The premiums on these insurance policies are recorded as expenditures in the year of payment.

The carrying basis of the 1988 Series A Capital Appreciation Bonds increases as a result of accretion of the original issuance discount. At June 30, 2002, the carrying basis was $ 45.410 million. At maturity on July 1, 2005, the carrying basis will equal the maturity amount of $51.5 million.

In prior years ($61.346 million) and fiscal year 2002 ($71 million), the ADOT refinanced various bond issues through advance refunding arrangements. Under the terms of the refunding bond issues, sufficient assets to pay all principal and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The assets, liabilities, and financial transactions of these trust accounts and the liability for the defeased bonds are not reflected in the accompanying financial statements. Refunded bonds for the ADOT at June 30, 2002 totaled $132.346 million.

The ADOT advance refunded the Highway Revenue Subordinated Series 1992B bonds ($6.870 million) and Senior Series 1999 Bonds ($64.130 million) to reduce its total debt service payments by $2.821 million and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of $2.473 million.

2. School Facilities Board

On December 20, 2001, the Arizona School Facilities Board issued $6.350 million in State School Improvement Revenue Bonds, Series 2001A (Qualified Zone Academy Bonds) to fund eligible school projects. It is estimated that at least 95% of the funds will be used for the purpose of renovating, rehabilitating, and equipping of school facilities within Federal Empowerment Zones, Enterprise Zones, or schools where 35% or more students are eligible for Free and Reduced Price Meals.

The Series 2001A Bonds are due in December 2002 through December 2006. The Series 2001A Bonds do not carry interest, but eligible bondholders are entitled to a credit against their Federal income tax equal to the product of the outstanding principal amount of the Series 2001A Bonds on said date multiplied by the credit rate as of the date of issuance of the Series 2001A Bonds.

Business Type Activities

3. Universities

a. University of Arizona

The University's bonded debt consists of various issues of system revenue bonds that are generally callable with interest payable semi-annually. Bond proceeds are used to pay for acquiring or constructing capital facilities and infrastructure. Bond proceeds are also used for refunding obligations from previously issued bonds. Principal and interest on bonds are secured by a pledge of tuition, fees, rentals, and other charges.

On February 6, 2002, the University sold System Revenue Refunding Bonds Series 2002 for $93.080 million dated March 1, 2002, with interest rates ranging from 3% to 5.25% and maturity dates ranging from 2003 to 2011. The bonds are not subject to redemption prior to their stated maturity. The Series 2002 bonds were sold at a premium of $4.692 million. The University realized net proceeds of $97.135 million after payment of $637 thousand for issuance costs, underwriter discounts

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

and bond insurance. The net proceeds were used to pay off higher interest rate System Revenue Bonds Series 1992, with an outstanding principal balance of $92.750 million. The Series 1992 bonds were called June 1, 2002. The current refunding decreased the University's total debt service requirements by $7.971 million and the University received an economic gain of $7.930 million (difference between the present values of the old debt and new debt service payments). The refunded debt is defeased and is not included in the accompanying financial statements.

Restricted cash and investments are held in trust for capital projects by various commercial banks. $2.655 million is held for debt requirements and $104.274 million is available for future construction costs. Trust funds are invested by the trustee in accordance with the Board's authorizing resolutions.

In fiscal year 1998, the University refunded, in advance of maturity, a portion of outstanding system revenue bonds Series 1994. At June 30, 2002, the outstanding principal balance of the refunded bonds was $15.740 million, which will be paid by investments held in trust with a carrying value of $17.287 million. These amounts are not included in the accompanying financial statements.

b. Northern Arizona University

The University's bonded debt consists of various issues of student housing and system revenue bonds that are generally callable with interest payable semiannually. Bond proceeds primarily pay for acquiring, constructing or renovating of capital facilities. System revenue bonds are repaid from pledged gross revenues that primarily consist of student tuition and fees, and certain auxiliary revenues.

During the year ended June 30, 2002, the University issued $43.945 million in system revenue refunding bonds with an average interest rate of 3.63% to advance refund $42.6 million of outstanding System Revenue Bonds, Series 1991, 1992 and 1992A, with an average interest rate of 5.95%. The Series 2002 bonds were issued at a premium of $795 thousand. The net proceeds of $44.332 million (after payment of $409 thousand in underwriting fees, insurance and other issuance costs) were used to purchase U.S. government obligations. Those securities were deposited in an irrevocable trust with a trustee to provide for all future debt service payments on the refunded bonds. As a result, the refunded debt is considered to be defeased, and the liability for those bond payments has been removed from the financial statements. On June 1, 2002, the monies in the depository trust were used to call the refunded bonds.

In prior years, the University defeased certain revenue bonds by either placing the proceeds of new bonds, or cash and investments accumulated in the sinking fund, in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the accompanying financial statements. At June 30, 2002, $360 thousand of such bonds outstanding are considered defeased.

c. Arizona State University

The Housing Revenue Bonds are payable from housing revenues as defined in the bond indentures. The Series 1992A, 1993 and 2002 System Revenue Refunding Bonds, and the outstanding Series 1989, 1991, 2000 and 2002 System Revenue Bonds are payable from Main Campus tuition, fees, certain auxiliary enterprise revenues, and certain other revenues as defined in the bond indentures.

The University has pledged portions of its gross revenues towards the payment of debt related to various system revenue bonds outstanding at June 30, 2002. These pledged revenues include student tuition and fees, auxiliary enterprises revenue, investment income, and indirect cost recovery revenue. Pledged revenues do not include state appropriations, gifts, endowment income, or other restricted revenues.

In June 2002, the University issued $85 million of system revenue bonds for the financing of construction and utility infrastructure improvement projects at the ASU main campus.

In March 2002, the University issued $141.4 million of system revenue refunding bonds, with an average interest rate of 4.16%, to refund the outstanding higher interest rate 1992 and 1992A system revenue refunding bonds totaling $144.9 million with an average interest rate of 5.72%.. The net proceeds of $149.9 million, after the net addition of $8.5 million for bond premium, underwriting fees, and other issuance costs, were used to purchase U.S. Government securities which were

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

deposited to an irrevocable trust in order to retire all remaining maturities of the 1992 and 1992A bonds on July 1, 2002. The refunded debt is considered defeased and related liabilities are not included in the accompanying financial statements. The issuance of the refunding bonds at a lower interest rate than the rate for the refunded debt resulted in a $13 million reduction in future debt service payments, with an economic gain of $12.2 million based upon the present value savings.

In prior years, certain system revenue bonds of the University were defeased through advance refunding by depositing sufficient U.S. Government securities to pay all future debt service in an irrevocable trust. Accordingly, liabilities for these defeased bonds are not included in the accompanying financial statements. The principal amount of all such bonds outstanding at June 30, 2002, was $193.9 million.

Securities and cash restricted for bond retirement funds and maintenance and replacement reserves held by trustees at June 30, 2002 totaled $16.4 million.

Component Units

4. Arizona Power Authority

In prior years, Arizona Power Authority (APA) defeased various issues of bonds by purchasing United States government securities which were deposited in an irrevocable trust with an escrow agent to provide future debt service until the call dates. As a result, those bonds are considered to be defeased and the liability has been removed from the Hoover Uprating Fund. Accordingly, these trust account asset and related liabilities are not included in the accompanying financial statements. The remaining bonds, totaling $68.945 million, bear interest rates from 4.9% to 5.4% and are due from 2003 through 2017. These bonds are secured by the pledged property, as defined by the resolution, which includes the proceeds from the sale of the bonds, rights and interests in various contracts and revenues of the APA.

5. University Medical Center

In March 1992, the University Medical Center (UMC) issued $28.405 million of Hospital Revenue Bonds (the Series 1992 Bonds) and in May 1993, the UMC issued $54.750 million of Hospital Revenue Refunding Bonds (the Series 1993 Bonds). The proceeds of the Series 1992 Bonds and the Series 1993 Bonds were used to advance refund a portion of prior bonds.

The UMC is subject to certain financial covenants under the Master Trust Indenture (the Indenture), with which the Center is in compliance as of and for the year ended June 30, 2002. In addition, the Indenture places certain restrictions on the incurrence of additional indebtedness and the sale or acquisition of property.

The UMC has established and maintains separate funds for borrowings not yet expended for construction. These funds are held by the trustee and are reflected in investments held by trustee in the accompanying financial statements, and consist principally of guaranteed investment contracts.

The bonds or other obligations of the UMC do not constitute general obligations of the Arizona Board Regents, the University of Arizona, the State of Arizona or any political subdivision thereof.

6. Water Infrastructure Finance Authority

The Water Infrastructure Finance Authority (WIFA) issued Financial Assistance Revenue Bonds in 1992, 1995, 1996, 1997 and 1998. The WIFA also issued Capitalization Revenue Bonds in 1992, 1995, 1996, 1997, and in 1999, WIFA also issued Water Quality Refunding Bonds. The bonds are callable and interest is payable semiannually. The bonds are special obligations of the WIFA payable solely from and secured by the WIFA's assets. The bonds are not obligations, general, specific or otherwise, of the State or any other political subdivision thereof other than the WIFA.

The $1.688 million deferred loss on retirement of bonds is being amortized over the lives of the defeased bonds on the straight-line basis. The amortization for the year ended June 30, 2002, is $142 thousand and has been included in interest expense.

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

Bond premiums are being amortized over the life of the bonds. The amortization for the year ended June 30, 2002, is $193 thousand and is offset against interest expense.

On September 8, 1999 the WIFA issued $64.000 million of Water Quality Refunding Bonds to advance refund all of the 1991A bonds, and part of the 1992A, 1995A, and 1996A bonds. Under the terms of the refunding issue, sufficient assets to pay all the principal and interest on the refunded bonds have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government securities which, together with the interest earned thereon, will provide amounts sufficient for future debt service requirements of the refunded bonds. The amount outstanding on the refunded bonds as of June 30, 2002 is $53.225 million. These bonds have been fully defeased, and, therefore, the corresponding liability has been removed from the accompanying financial statements.

On December 12, 2001, the Water Infrastructure Finance Authority (WIFA) issued $110.000 million of water quality revenue bonds (the "Series 2001A Bonds") with interest rates ranging from 4.0% to 5.375% to (1) fund certain loans made by the WIFA to finance water quality projects and to reimburse the WIFA monies previously loaned for those purposes, (2) make a deposit to the reserve account and (3) pay issuance costs of the Series 2001A bonds. The bonds are due October 1, 2002 through 2021. Net proceeds totaled $102.577 million (after receipt of $4.823 million of original issue premium, deposit of $11.458 million to the reserve account, and payment of $788 thousand bond issuance costs).

7. Summary of Revenue Bonds

The following schedule summarizes revenue bonds outstanding at June 30, 2002 (expressed in thousands):

Revenue Bonds Outstanding	Dates Issued	Maturity Dates	Interest Rates	Amount Authorized	Amount Issued	Outstanding Balance at June 30, 2002
Governmental Activities:						
Department of Transportation	1988-2002	2003-2020	2.0-8.8%	$2,496,580	$2,496,580	$1,337,045
School Facilities Board	2001-2002	2002-2019	3.25-5.5%	800,000	488,500	445,465
Business Type Activities:						
University Revenue Bonds	1961-2002	2001-2027	2.7-7.1%	1,097,456	1,024,356	596,403
Component Units:						
Arizona Power Authority	1993	2003-2017	4.9-5.4%	68,945	68,945	68,945
University Medical Center	1992-1993	2003-2021	5.53-6.11%	83,155	83,155	73,615
Water Infrastructure Finance Authority	1992-2002	2005-2022	3.7-6.1%	253,715	253,715	241,855

Principal and interest debt service payments on revenue bonds outstanding at June 30, 2002 for the Primary Government are as follows (expressed in thousands):

	Annual Debt Service					
	Governmental Activities			Business-Type Activities		
Fiscal Year	Total Principal	Total Interest	Total	Total Principal	Total Interest	Total
2003	$ 238,050	$ 67,392	$ 305,442	$ 30,980	$ 30,890	$ 61,870
2004	268,865	79,617	348,482	31,907	28,235	60,142
2005	280,995	66,811	347,806	37,046	26,692	63,738
2006	75,300	52,160	127,460	41,960	24,847	66,807
2007	77,435	48,331	125,766	41,595	22,925	64,520
2008-2012	400,180	178,107	578,287	191,955	84,060	276,015
2013-2017	271,380	87,908	359,288	147,760	37,635	185,395
2018-2022	170,305	17,488	187,793	34,525	14,442	48,967
2023-2027	-	-	-	32,725	5,112	37,837
2028-2032	-	-	-	5,950	-	5,950
Total	$1,782,510	$597,814	$ 2,380,324	$ 596,403	$ 274,838	$ 871,241

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

Principal and interest debt service payments on revenue bonds outstanding at June 30, 2002 for the Component Units are as follows (expressed in thousands):

	Component Units		
Fiscal Year	Total Principal	Total Interest	Total
2003	$ 15,740	$ 18,866	$ 34,606
2004	15,695	19,262	34,957
2005	17,165	19,072	36,237
2006	19,000	18,928	37,928
2007	20,365	18,355	38,720
2008-2012	113,700	71,556	185,256
2013-2017	120,545	35,301	155,846
2018-2022	62,205	6,956	69,161
Total	$ 384,415	$ 208,296	$ 592,711

B. GRANT ANTICIPATION NOTES

The Grant Anticipation Notes Fund administers all payments of principal and interest for notes issued by the Transportation Board and is secured by revenues received from the Federal Highway Administration under a grant agreement and certain other federal-aid revenues. The original amount of grant anticipation notes issued was $182.295 million.

The following schedule summarizes grant anticipation notes outstanding at June 30, 2002 (expressed in thousands):

Grant Anticipation Notes Outstanding	Dates Issued	Maturity Dates	Interest Rates	Amount Authorized	Amount Issued	Outstanding Balances at June 30, 2002
Governmental Activities:						
Department of Transportation	2000-2001	2004-2008	4.0-5.3%	$ 182,295	$ 182,295	$ 182,295

Future debt service principal and interest payments on grant anticipation notes issues for fiscal years ended June 30 are summarized below (expressed in thousands):

	Annual Debt Service		
	Governmental Activities		
Fiscal Year	Total Principal	Total Interest	Total
2003	$ 13,150	$ 8,683	$ 21,833
2004	36,755	7,488	44,243
2005	49,000	5,401	54,401
2006	38,540	3,209	41,749
2007	37,000	1,308	38,308
2008-2012	7,850	196	8,046
Total	$ 182,295	$ 26,285	$ 208,580

C. CERTIFICATES OF PARTICIPATION

1. Department of Administration

The State has issued Certificates of Participation (COPs) to finance construction or improvements of office buildings that are primarily leased to State agencies. The State's obligation to make lease payments and any other obligations of the State under the lease are subject to, and dependent upon, annual appropriations made by the State Legislature and annual allocations of such

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

appropriations being made by the Department of Administration for such purpose. The Department of Administration agrees to use its best efforts to budget, obtain, allocate and maintain sufficient appropriated monies to make lease payments. In the event any such appropriation and allocation is not made, the Lease will terminate and there can be no assurance that the proceeds for the re-leasing or sale of the project will be sufficient to pay principal and interest with respect to the then outstanding Certificates. The scheduled payments of principal and interest with respect to the Certificates of Participation are guaranteed under certificate insurance policies. The State's obligation to make lease payments does not constitute a debt or liability of the State within the meaning of any constitutional or statutory limitation. Neither the full faith and credit nor the general taxing power of the State is pledged to make payments of principal or interest due with respect to the Certificates of Participation. Such payments will be made solely from amounts derived under the terms of the lease, including lease payments, and amounts from time to time on deposit under the terms of the declaration of trust.

Capitalized interest costs include interest incurred during the construction of an asset.

The December 1993 COPs for the Department of Administration were issued to refund the December 1989 and October 1990 certificates. Sufficient assets were deposited in an irrevocable trust to provide for all future debt service requirements of the refunded COP's. The total amount refunded was $31.815 million. This amount is considered defeased and is not included in the accompanying financial statements.

On November 1, 2001, the State issued the 2001A Certificates of Participation in the amount of $56.480 million, and the 2001B Certificates of Participation in the amount of $1.450 million to: (i) refund all of the Series 1991 Certificates of Participation currently outstanding in the amount of $36.025 million, (ii) refund all of the Series 1992A Certificates of Participation currently outstanding in the amount of $15.640 million, and (iii) refund all the Series 1992C Certificates of Participation currently outstanding in the amount of $10.330 million. Sufficient assets were deposited in an irrevocable trusts at commercial banks to provide for all future debt service requirements of the refunded COP's

The above refunding reduced the State's debt service requirements by $13.258 million, which resulted in an economic gain (difference between the present values of the old and new debt service payments) of $13.294 million.

The Series 2002A Certificates of Participation for the Department of Administration were issued for $63.270 million to finance a portion of the costs of acquisition, construction and improvement of a new laboratory facility (the "State Health Lab") for the State Department of Health Services, Bureau of State Laboratory Services and the acquisition, design, and implementation of a new human resources information system for the State (the HRIS), and to pay the costs of issuing the Series 2002A certificates.

2. Industrial Commission

The 1985 COPs for the Industrial Commission were issued to refund the 1984 certificates that were issued to finance the cost of acquiring and constructing a building. Sufficient assets were deposited in an irrevocable trust to provide for all future debt service requirements of the refunded COPs. The lease agreement provides that the title will pass to the Industrial Commission at the end of the lease term, once the COPs are completely redeemed. The refunded amount was $17.500 million. This amount is considered paid and is not included in the outstanding amounts.

3. University of Arizona

On December 12, 2001, the University of Arizona issued Certificates of Participation, Series 2001B for $21.425 million. The 2001B Certificates have an optional redemption date of June 1, 2012. There are also extraordinary redemption dates pursuant to the debt documents. The 2001B Certificates include $13.915 million of serial certificates with interest rates ranging from 3.0% to 5.0% and maturity dates ranging from 2003 to 2017. The 2001B Certificates also include $7.510 million of term certificates due June 1, 2022 with an interest rate of 5.125%. The 2001B Certificates were issued at a discount of $99 thousand. The proceeds are being used to construct the Highland District Residence Life Infrastructure, reconfigure the Arizona Health Sciences Center Animal Facility, and expand the Gittings Dance Hall.

On April 4, 2002, the University of Arizona issued Certificates of Participation, Series 2002A in the amount of $76.965 million with interest rates ranging from 3.75% to 5.5% and maturity dates ranging from 2003 to 2022. The certificates have an optional

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

redemption date of June 1, 2012. The Certificates of Participation, Series 2002A were sold at a premium of $1.439 million. The University realized net proceeds of $77.318 million after payment of $1.086 million for issuance costs, underwriters discount and bond insurance. The net proceeds for the sale of these certificates are being used to finance the construction of a new Highland District Student Residential Hall, a new Campus Health Facility, and the University North Building located northwest of Tucson. In addition, a portion of the proceeds were used to advance-refund two certificates of participation Series 1991 and 1992 with a total outstanding principal balance of $16.735 million, and a call date of July 15, 2002. The advance refunding reduced the University's total debt service requirements for the two certificates of participation by $319 thousand, and provided a net present value cash flow benefit of $1.169 million. The refunded Certificates of Participation Series 1991 and 1992 will be paid by investments held in an irrevocable trust with a combined carrying value of $17.509 million. The refunded debt is considered defeased and is not included in the accompanying financial statements.

The University of Arizona had outstanding at June 30, 2002, two Variable Rate Certificates of Participation Series 1999B and 2000A totaling $64.2 million. Both certificates bear interest at a weekly rate determined by Paine Webber, as remarketing agent, with final maturity dates of June 1, 2024 and June 1, 2025, respectively. These certificates are subject to conversion, at the option of the Arizona Board of Regents, to an adjustable rate, an annual rate, or a term rate pursuant to the debt documents. If not converted, the 1999B and 2000A certificates will bear interest at a weekly rate not to exceed 12 percent per annum determined under prevailing market conditions by the remarketing agent.

4. Arizona State University

In June 2002, Arizona State University issued $103.8 million of certificates of participation for the financing of construction and renovation projects at the ASU Main, ASU West, and ASU East Campuses.

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

A summary of the COPs issued as of June 30, 2002, is as follows (expressed in thousands):

Project	Issue Date	Maturity Date	Amount Authorized And Issued	Outstanding Balance	Interest Rates
Governmental Activities:					
Arizona Municipal Financing Program	1992	2010	$ 129,640	$ 88,645	3.4 – 6.25%
School for the Deaf and Blind/Game and Fish	1993	2011	31,250	19,815	2.75 – 5.0
Refunding Certificates of 92A, 92C, & 1091	2001	2011	57,930	57,930	3.25 – 5.25
Health Lab/HRIS	2002	2022	63,270	60,820	3.0 – 5.5
AHCCCS	1994	2005	12,642	4,694	6.66
Total Governmental Activities:			$ 294,732	$ 231,904	
Business-Type Activities:					
Industrial Commission Special Fund	1985	2005	$17,500	$ 7,400	1.90 – 3.40%
Arizona State University:					
Towers Project	1991	2010	4,500	2,885	6.89
West Campus - Refunding	1993	2009	46,905	33,675	5.18
Downtown Center – A	1999	2024	5,620	5,495	5.75
Downtown Center – B	1999	2024	5,165	5,085	8.00
2002 Certificates of Participation	2002	2026	103,800	103,800	4.75
University of Arizona:					
Residence Life	1994	2014	16,725	12,775	4.1 – 5.8
Maingate Admin	1994	2024	16,170	14,470	4.25 – 6.0
Alumni Foundation	1997	2008	2,965	1,920	3.8 – 4.5
Fixed Student Union A	1999	2024	21,607	21,980	5.0 – 5.3
Student Union B	1999	2024	36,500	36,500	Variable not to exceed 12
Parking Garage/Residence Hall	1999	2024	18,635	18,380	4.2 – 5.75
McKale/UAPD/Mt. Graham	2000	2025	28,300	27,700	Variable not to exceed 12
Park Student Union/Ln Svcs/6th St Gar	2001	2025	31,695	31,555	3.4 – 5.5
Gittings Bldg. Highland Infra. Life Sci.	2001	2022	21,425	21,425	3.0 – 5.125
Student Housing, Health Bldg., UA North	2002	2022	76,965	76,965	3.75 – 5.5
Total Business Type Activities:			$ 454,477	$ 422,010	
Total Certificates of Participation:			$ 749,209	$ 653,914	

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

Principal and interest debt service requirements on COPs outstanding at June 30, 2002, are as follows (expressed in thousands):

	Annual Debt Service					
	Governmental Activities			Business-Type Activities		
Fiscal Year	Total Principal	Total Interest	Total Amount Required	Total Principal	Total Interest	Total Amount Required
2003	$ 15,103	$ 11,350	$ 26,453	$ 9,950	$ 19,851	$ 29,801
2004	17,242	11,475	28,717	15,705	17,768	33,473
2005	19,022	10,535	29,557	15,300	17,207	32,507
2006	19,191	9,519	28,710	17,585	16,522	34,107
2007	21,230	8,465	29,695	15,100	15,848	30,948
2008-2012	115,820	22,753	138,573	81,935	68,576	150,511
2013-2017	12,275	4,247	16,522	93,574	53,298	146,872
2018-2022	9,745	1,852	11,597	119,821	24,893	144,714
2023-2027	2,276	58	2,334	53,040	4,062	57,102
Total	$ 231,904	$ 80,254	$ 312,158	$ 422,010	$ 238,025	$ 660,035

D. LEASES AND INSTALLMENT PURCHASES

1. Leases

The total operating lease expenditures for the fiscal year ended June 30, 2002, were $43.291 million for governmental activities, $17.052 million for business-type activities, and $1.256 million for the Component Units. The future minimum lease payments for long-term operating leases as of June 30, 2002, are summarized below (expressed in thousands):

	Primary Government			
Fiscal Year	Governmental Activities	Business-Type Activities	Component Units	Total
2003	$ 30,840	$ 2,592	$ 1,718	$ 35,150
2004	24,074	2,144	639	26,857
2005	18,225	851	488	19,564
2006	11,632	652	465	12,749
2007	6,372	365	110	6,847
2008-2012	718	372	269	1,359
Total Future Minimum Payments	$ 91,861	$ 6,976	$ 3,689	$ 102,526

Many operating leases are for buildings and land leased by State agencies. Although these leases are considered to be long-term, they are cancelable under certain circumstances.

* An agency must be able to cancel the lease if monies are not appropriated to cover the lease expenditures.

* If an agency is ordered to move into State-owned property and a 60-day notice is given, the lease can be canceled without penalty.

* In situations where the use of the leased property is dependent on the use of Federal monies, the lease must be cancelable in the event Federal monies are no longer available.

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

The State has entered into capital lease agreements for the acquisition of telephone systems, copy machines and other equipment.

The future minimum lease payments for long-term capital leases (all primary government) as of June 30, 2002 are summarized below (expressed in thousands):

	Annual Debt Service					
	Governmental Activities			Business-Type Activities		
Fiscal Year	Principal	Interest	Total	Principal	Interest	Total
2003	$ 1,384	$ 422	$ 1,806	$ 9,323	$ 1,327	$ 10,650
2004	1,191	365	1,556	8,898	1,218	10,116
2005	1,132	305	1,437	6,612	819	7,431
2006	1,042	247	1,289	5,987	524	6,511
2007	918	194	1,112	4,750	272	5,022
2008-2012	2,850	280	3,130	1,966	229	2,195
2013-2017	0	0	0	222	12	234
Totals	$ 8,517	$ 1,813	$ 10,330	$ 37,758	$ 4,401	$ 42,159

2. Installment Purchases

The State has installment purchase contracts payable for acquisitions of computer and other equipment. Installment purchases assets and liabilities are reported in the government wide Statement of Net Assets.

The future minimum payments for long-term installment purchases (all primary government) as of June 30, 2002, are summarized below (expressed in thousands):

	Annual Debt Service					
	Governmental Activities			Business-Type Activities		
Fiscal Year	Principal	Interest	Total	Principal	Interest	Total
2003	$ 4,665	$ 389	$ 5,054	$ 797	$ 216	$ 1,013
2004	4,116	165	4,281	459	169	628
2005	1,020	38	1,058	379	142	521
2006	276	14	290	382	120	502
2007	151	2	153	294	98	392
2008-2012	-	-	-	1,521	270	1,791
Total future Minimum payments	$ 10,228	$ 608	$ 10,836	$ 3,832	$ 1,015	$ 4,847

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

3. Capital Assets Financed through Capital Leases and Certificates of Participation

The following table summarizes historical cost of assets acquired under capital leases and certificates of participation:

	Governmental Activities	Business-Type Activities
Land	$ 6,078	$ -
Construction in Progress	12,049	-
Buildings	198,457	237,824
Improvement other than Building	3,653	-
Equipment	12,394	-
	232,631	237,824
Accumulated Depreciation	65,461	31,093
Net Certificates of Participation and Capital Lease Assets	$ 167,170	$ 206,731

E. NOTES PAYABLE

The Arizona Department of Transportation (ADOT) notes payable as of June 30, 2002 was $338.386 million. The governmental activities notes payable was $192.849 million, and the business-type activities notes payable was $145.536 million. The notes payable represent the State Highway Fund loan payable to the Highway Expansion and Loan Program Fund (H.E.L.P.) for $93.980 million, the Maricopa Regional Area Road Construction Fund loan payable to the City of Mesa for $33.166 million, the Equipment Fund loan payable to creditors for $5.693 million, and the Board Funding Obligations for loans from the State Treasurer for $205.547 million. The total outstanding for Board Funding Obligations is as follows:

1. Laws 1999, Chapter 189 (SB 1201) authorized a Board Funding Obligation (BFO) of $100 million to the H.E.L.P. fund in fiscal year 2000. Both the principal and interest of the BFO are due on March 14, 2004 ($43.115 million) and June 27, 2004 ($62.315 million), respectively.

2. Laws 2001, Chapter 238 (HB 2636) authorized a Board Funding Obligation (BFO) of $40 million to the H.E.L.P. fund in fiscal year 2002. Interest accrued to date is $107 thousand. Both principal and interest of the BFO are due no later than May 31, 2004.

3. Laws 2001, Chapter 238 (HB 2636) authorized a Board Funding Obligation (BFO) of $60 million to the State Highway Fund in fiscal year 2002. Interest accrued to date is $10 thousand. Both principal and interest of the BFO are due no later than May 31, 2004.

F. LITIGATION

The amounts shown for the *Ladewig vs. Waddell* case and the *Roosevelt Elementary School District No. 66 vs. State of Arizona* case are further discussed in Note 12 – *Commitments, Contingencies, and Compliance*.

NOTE 6. LONG-TERM OBLIGATIONS (CONTINUED)

G. CHANGES IN LONG-TERM OBLIGATIONS

The following is a summary of changes in Long-Term Obligations (expressed in thousands):

	Restated Balance July 1, 2001	Additions	Retirements	Balance June 30, 2002	Due Within One Year	Due Thereafter
Governmental Activities:						
Long-term Debt:						
Revenue Bonds	$ 1,882,765	$ 222,600	$ (322,855)	$ 1,782,510	$ 238,050	$ 1,544,460
Grant Anticipation Notes	182,295	-	-	182,295	13,150	169,145
Certificates of Participation	168,258	139,254	(75,608)	231,904	15,103	216,801
Capital Leases	9,390	904	(1,777)	8,517	1,384	7,133
Installment Purchase Contracts	9,767	4,834	(4,373)	10,228	4,665	5,563
Notes Payable	-	204,707	(11,858)	192,849	82,172	110,677
Revenue Bond Premium	19,766	10,142	(1,882)	28,026	2,358	25,668
Certificates of Participation Premium	-	4,674	-	4,674	350	4,324
Total Long-term Debt	2,272,241	587,115	(418,353)	2,441,003	357,232	2,083,771
Other Long-term Liabilities:						
Compensated Absences	123,646	147,227	(130,699)	140,174	132,473	7,701
Ladewig vs. Waddell Settlement	-	350,000	-	350,000	-	350,000
Roosevelt School District Settlement	-	88,000	-	88,000	-	88,000
Total other Long-term Liabilities	123,646	585,227	(130,699)	578,174	132,473	445,701
Total Long-term Obligations	$ 2,395,887	$ 1,172,342	$ (549,052)	$ 3,019,177	$ 489,705	$ 2,529,472
Business Type Activities:						
Revenue Bonds	$ 540,019	$ 363,405	$ (307,021)	$ 596,403	$ 30,980	$ 565,423
Certificates of Participation	244,934	202,326	(25,250)	422,010	9,950	412,060
Capital Leases	29,259	13,951	(5,452)	37,758	9,323	28,435
Installment Purchase Contracts	1,634	3,229	(1,031)	3,832	797	3,035
Notes Payable	-	145,536	-	145,536	-	145,536
Revenue Bond Premium	-	11,674	(289)	11,385	-	11,385
Deferred Amount on Refundings	-	(6,759)	1,445	(5,314)	(150)	(5,164)
Certificates of Participation Premium	-	2,682	(2)	2,680	-	2,680
Total Long-term Debt	815,846	736,044	(337,600)	1,214,290	50,900	1,163,390
Other Long-term Liabilities:						
Compensated Absences	40,611	46,295	(40,591)	46,315	46,143	172
Total other Long-term Liabilities	40,611	46,295	(40,591)	46,315	46,143	172
Total Long-term Obligations	$ 856,457	$ 782,339	$ (378,191)	$ 1,260,605	$ 97,043	$ 1,163,562
Component Units:						
Revenue Bonds	$ 282,730	$ 110,000	$ (8,315)	$ 384,415	$ 15,740	$ 368,675
Revenue Bond Discount	(4,816)	-	256	(4,560)	-	(4,560)
Revenue Bond Premium	335	4,822	(193)	4,964	-	4,964
Total Long-term Debt	278,249	114,822	(8,252)	384,819	15,740	369,079
Other Long-term Liabilities:						
Compensated Absences	3,161	12,831	(8,074)	7,918	3,506	4,412
Total other Long-term Liabilities	3,161	12,831	(8,074)	7,918	3,506	4,412
Total Long-term Obligations	$ 281,410	$ 127,653	$ (16,326)	$ 392,737	$ 19,246	$ 373,491

NOTE 6. LONG-TERM OBLIGATIONS (CONCLUDED)

The above long-term obligations relating to governmental activities include internal service funds. Amounts for installment contracts and compensated absences differ from those in the Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets because liabilities of $1.488 million of installment contracts and $11.352 million of compensated absences are attributable to internal service funds. These amounts are included in the reconciliation as part of internal service fund net assets and liabilities. An additional $1.660 million in compensated absences was recorded as a current liability in the fund financial statements; however, this amount was reclassified in the government wide statement of net assets to current portion of other long-term liabilities. Therefore, this amount is included in the Long-Term Obligation footnote, but is not a reconciling item between the governmental funds balance sheet and the government-wide statement of net assets.

NOTE 7. INTERFUND TRANSACTIONS

INTERFUND BALANCES AND TRANSFERS

Interfund Receivables/Payables

Interfund balances as of June 30, 2002 are as follows (expressed in thousands):

	Due To						
Due From	General Fund	Transportation & Aviation Fund	Land Endowments Fund	Non-Major Governmental Funds	Non-Major Enterprise Funds	Internal Service Funds	Total Due To
General Fund	$ -	$ 22,127	$ 1,390	$ 7,929	$ 166	$ 1,550	$ 33,162
Transportation & Aviation Fund	-	-	-	-	571	168	739
Non-Major Governmental Funds	517	-	-	277	1,914	122	2,830
Unemployment Compensation Fund	19	-	-	194	-	-	213
Lottery	2,239	-	-	7,238	-	-	9,477
Non-Major Enterprise Funds	3,009	20,000	-	-	-	-	23,009
Internal Service Funds	244	2	-	-	-	273	519
Total Due From	$ 6,028	$ 42,129	$ 1,390	$ 15,638	$ 2,651	$ 2,113	$ 69,949

Interfund balances represent (1) amounts due to and from the internal service funds for goods and services rendered, and (2) Cash transferred between funds subsequent to the balance sheet date. The cash is recorded in the fund, which initiated the transfer, and a corresponding liability is recorded. The receiving fund records an interfund receivable.

Interfund Transfers

Transfers for the year ended June 30, 2002 are as follows (expressed in thousands):

	Transferred To							
Transferred From	General Fund	Transportation & Aviation Fund	Land Endowments Fund	Non-Major Governmental Funds	University Funds	Non-Major Enterprise Funds	Internal Service Funds	Total Transfers Out
General Fund	$ -	$ 3,526	$ 349	$ 75,878	$ 766,185	$ 252	$ 4	$ 846,194
Transportation & Aviation Fund	52,174	-	-	317,890	-	-	-	370,064
Non-Major Governmental Funds	194,962	3,899	-	122,783	-	5,056	2	326,702
Unemployment Compensation	212	-	-	1,169	-	125	-	1,506
Lottery	33,498	-	-	21,675	-	-	-	55,173
Non-Major Enterprise Funds	3,023	-	-	2,000	-	-	-	5,023
Internal Service Funds	10,088	-	-	5,126	-	-	-	15,214
Total Transfers In	$ 293,957	$ 7,425	$ 349	$ 546,521	$ 766,185	$ 5,433	$ 6	$1,619,876

NOTE 7. INTERFUND TRANSACTIONS (CONCLUDED)

Interfund transfers represent legally authorized non-exchange transfers of funds. These transfers include: (1) Legislative appropriations from the general fund, (2) other legislative transfers, (3) Statutorily required transfers, (4) transfers related to the elimination of funds, and (5) transfers for debt service.

NOTE 8. ACCOUNTING CHANGES AND RESTATEMENTS

During fiscal year 2002, the State implemented several new accounting standards issued by GASB:

No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments,
No. 35, Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities,
No. 37, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus, and
No. 38, Certain Financial Statement Note Disclosures.

Statement No. 34, as amended by Statement No. 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state governments, including statement formats and changes in fund types and account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior year financial statement balances were required.

Statement No. 35 establishes accounting and financial reporting standards for public colleges and universities within the financial reporting guidelines of Statement No. 34. The State universities, reported as major proprietary funds, adopted the requirements of Statement No. 35.

Statement No. 38 requires certain footnote disclosures when Statement No. 34 is implemented.

The Land Endowment Fund beginning fund balance was restated due to GASB 34 to reflect (1) the removal of capital assets, net of accumulated depreciation in the amount of ($12.585) million at the fund level because the Land Endowment Fund was reported using the full accrual basis of accounting in prior years, and (2) the net effect of earned revenue which was not recorded in prior years in the amount of $9.880 million. In addition to the GASB Statement implementations, four corrections of errors were made. The General Fund beginning fund balance was restated by $134.888 million to correct income tax revenue recorded in the prior year that were not earned. The Transportation and Aviation Fund fund balance was restated by $36.817 million. This restatement is due to the ADOT incorrectly excluding funds received from the General Fund in prior years. Non-Major governmental funds beginning fund balance was restated by $13.759 million to reflect an unrecorded liability at June 30, 2001. Other funds were reclassified to the Enterprise funds and internal service funds due to review of proper fund type. These reclassifications are unrelated to GASB 34 implementation.

The provisions of these new standards have been incorporated into the financial statements and notes. The following table summarizes (in thousands) changes to fund equities as previously reported in the Combined Balance Sheet. These changes resulted primarily from implementation of these GASB statements, except as noted above.

NOTE 8. ACCOUNTING CHANGES AND RESTATEMENTS (CONCLUDED)

Fund Balances and Net Assets at June 30, 2001 have been restated as follows (expressed in thousands):

	June 30, 2001 as Previously Reported	GASB 34 Fund Reclassifications	Corrections of Errors	Adoption of GASB 34	July 1, 2001 As Restated
Governmental Funds and Activities					
General fund	$ 1,380,364	$ 63,407	$ (134,888)	$	$ 1,308,883
Transportation & Aviation	26,444	319,587	36,817	-	382,848
Land Endowments	-	1,083,327	-	(2,705)	1,080,622
Non-Major Funds	1,942,122	(402,633)	(13,579)	-	1,525,910
Total Governmental Funds Fund Balances	3,348,930	1,063,688	(111,650)	(2,705)	4,298,263
Adoption of GASB No. 34:					
Revenue Recognition	-	125,071	-	58,373	183,444
Capital assets, net depreciation	-	1,895,189	-	8,938,663	10,833,852
Revenue Bonds	-	-	-	(1,882,765)	(1,882,765)
Grant Anticipation Notes	-	-	-	(182,295)	(182,295)
Certificates of Participation	-	-	-	(167,012)	(167,012)
Capital Leases	-	-	-	(9,390)	(9,390)
Installment Purchases	-	-	-	(9,759)	(9,759)
Revenue Bond Premium	-	-	-	(19,766)	(19,766)
Certificates of Participation Premium	-	-	-	(1,246)	(1,246)
Compensated Absences	-	-	-	(123,646)	(123,646)
Internal Service Fund consolidation	-	(90,777)	-	-	(90,777)
Compensated Absences reclassified to			-		
Internal Service Funds	-	-	-	8,844	8,844
Other Restatements	-	-	-	4,985	4,985
Adoption of GASB No. 34	-	1,929,483	-	6,614,986	8,544,469
Total Governmental Funds Net Assets	$ 3,348,930	$ 2,993,171	$ (111,650)	$ 6,612,281	$ 12,842,732

	June 30, 2001 as Previously Reported	GASB 34/35 Fund Reclass-ifications	Other Fund Reclassifications	Adoption of GASB 35	July 1, 2001 As Restated
Proprietary Funds and Business-Type Activities					
Lottery	$ 8,675	$ -	$ -	$ -	$ 8,675
Industrial Commission	80,073	-			80,073
Universities	-	3,246,629		(1,567,461)	1,679,168
Unemployment				-	
Compensation	-	1,051,658			1,051,658
Non-major Enterprise funds	52,090	-	79,235		131,325
Total Proprietary Funds and Business-type Activities	$ 140,838	$ 4,298,287	$ 79,235	$ (1,567,461)	$ 2,950,899
Internal Service Funds	$ (96,922)	-	$ 6,145	$ -	$ (90,777)
Fiduciary Funds	$ 32,989,607	$ (2,363,035)	$ -	$ -	$ 30,626,572
Account Groups					
General Fixed Assets	$ 1,895,189	$ (1,895,189)	$ -	$ -	$ -
General Long-term Debt	-	-			-
Total Account Groups	$ 1,895,189	$ (1,895,189)	$ -	$ -	$ -
Universities	$ 3,246,629	$ (3,246,629)	$ -	$ -	$ -

NOTE 9. FUND DEFICIT

The Internal Service Funds deficit results from the Risk Management Fund net losses in prior years. The Risk Management Fund deficit of $207.039 million is primarily due to the State's policy of funding 50% of the actuarially determined liability. However, 100% of the liability is recorded for financial statement purposes. The Risk Management Fund accumulated deficit at June 30, 2002, should be recovered through annual adjustments to insurance billings. The entire liability is reflected in the Internal Service Funds. Current period losses are allocated to functions of government in the government-wide statement of activities.

NOTE 10. RELATED PARTY TRANSACTIONS

A. ARIZONA STATE UNIVERSITY

Not included in the accompanying financial statements are six financially interrelated organizations that are nonprofit corporations controlled by separate Boards of Directors whose goals are to support Arizona State University. Financial statements of these organizations are audited by independent auditors.

Four of these financially interrelated organizations (the Arizona State University Alumni Association, Arizona State University Foundation, Sun Angel Foundation and the Sun Angel Endowment) receive funds primarily through donations and dues, and contribute funds to the University for support of various programs.

A fifth financially interrelated organization, Price-Elliott Research Park, Inc. (Park), is developing a research park to promote and support research activities, in coordination with the University. In developing the research park, the Park has issued bonds guaranteed by the University.

As of June 30, 2002, the Park had $18.0 million of revenue bonds outstanding at an average interest rate of 5.26%. The debt service on the bonds is secured by a subordinated lien on University Main Campus revenues. Park revenues are not pledged in order to provide development flexibility to the Park.

Annual debt service on the Park bonds will be $1.0 million in fiscal year 2003 and varies from a low of $900 thousand in fiscal year 2004 to a high of $1.7 million in fiscal year 2006. The University is obligated to pay the annual debt service, if not paid by the Park, under a debt service assurance agreement.

Beginning in fiscal year 1990, the University provided operating cash advances to the Park repayable with interest to the University (1) upon the Park's total gross receipts for a fiscal year exceeding its total disbursements for the fiscal year and (2) before any Park surpluses are transferred to the Arizona State University Foundation, for the benefit of Arizona State University. The last year for cash transfers to the Park was fiscal year 1998. Since the Park's repayment to the University was dependent upon successful future operations and entering into additional land leases, the transfers to the Park were recorded by the University as current year expenditures when made and not as an asset on the University's balance sheet. Total cash advances repayable to the University at June 30, 2002, including the accrued interest, totaled $6.5 million. During fiscal year 2002, the Park repaid $1.3 million to the University, with this amount being recorded as other revenues with the timetable for future repayments dependent upon the Park entering into additional land leases.

A sixth financially interrelated organization, the Collegiate Golf Foundation, operates a University-owned golf course.

Assets, net assets, and revenues for these organizations for the most recent fiscal year for which audits have been completed aggregated $293.5, $231.3 and $31.5 million, respectively, with substantially all of the net assets being donor restricted or endowment funds.

The University has, or is in the process of entering into several privatized arrangements for on-campus student housing and campus energy management where an independent management company is responsible for providing services to the University

NOTE 10. RELATED PARTY TRANSACTIONS (CONTINUED)

and/or students served by the University. In conjunction with these privatized arrangements, the independent management companies, with the approval and assistance of the University have obtained, or are in the process of obtaining, tax-exempt financing in order to maximize the overall financial benefits to the University and its students. As of June 30, 2002, two tax-exempt financings had been completed by an independent management company through separately incorporated non-profit entities formed by the independent companies to do the tax-exempt financings. The University is not legally responsible for repayment of the tax-exempt debt, and there is no pledge or guarantee by the University for repayment of the debt. On June 20, 2002, there was $32.1 million of bonds outstanding for these two privatized arrangements with approximately $50.0 million of financings for two other privatized arrangements being in process. Upon final principal repayment of the financings, title to the student housing and energy management equipment transfers to the University.

B. NORTHERN ARIZONA UNIVERSITY

The financial activities of the Northern Arizona University Foundation, Inc., (Foundation) and the Northern Arizona Capital Facilities Finance Corporation (NACFFC) are not included in the accompanying financial statements. The Foundation and the NACFFC are nonprofit corporations controlled by separate Boards of Directors. The goals of the Foundation are to promote the cause of education and the objectives of the University. The NACFFC was formed for the purpose of building on-campus student housing.

The NACFFC, with the approval and assistance of the University, has obtained tax-exempt financing to construct a student housing facility. The University is not legally responsible for repayment of the tax-exempt debt, and there is no pledge or guarantee by the University for repayment. The housing facility was opened in the fall of 2002 and daily operations are managed by the University. On June 20, 2002, there were $15.4 million of bonds outstanding for this privatized arrangement. Upon final principal repayment of the financing, title to the student housing transfers to the University. This housing is built on University property that is leased to the NACFFC for the term of the bond issue.

C. UNIVERSITY OF ARIZONA

The accompanying financial statements do not include the operations of the University of Arizona Foundation, Inc., the University Physicians, Inc., the Arizona Research Park Authority, and the Campus Research Corporation.

The University of Arizona Foundation, Inc. (Foundation) is a nonprofit corporation controlled by a separate Board of Directors. The principal goals of the Foundation are to support the University of Arizona through various fund-raising activities, and to contribute funds to the University for support of various programs. According to the audited financial statements of the Foundation for the year ended June 30, 2001, assets, liabilities, revenues, and expenditures totaled $299, $29, $72 and $45 million, respectively.

The University Physicians, Inc. (UPI) is a nonprofit corporation established to support the University of Arizona in achieving its teaching and research missions through the provision of patient care. The UPI is controlled by a Board of Directors, comprised of the Dean, three faculty physicians, a representative of the twelve clinical department heads and three community members. According to the audited financial statements of the UPI for the year ended June 30, 2001, assets, liabilities, revenues and expenditures totaled $104, $53, $145 and $135 million, respectively.

The Arizona Research Park Authority (ARPA) is a nonprofit corporation created under the auspices of the Arizona Board of Regents (ABOR) and designated by Arizona law as a political subdivision of the State, governed by a separate board of directors, which by law may not include officers or employees of ABOR. The ARPA was established under the State's industrial development authority statute to assist in the acquisition, improvement, and operation of university research parks and related properties. In August 1994, ARPA, with approval of ABOR, sold $98 million of nontransferable special revenue bonds to International Business Machines Corporation (IBM) to enable the University to acquire from IBM a 345-acre developed industrial site near Tucson, Arizona, together with 1,000 acres of adjacent unimproved land (collectively, the University of Arizona Science and Technology Park or the "Park"). The bonds are payable solely from lease rentals paid by IBM. If IBM defaults or cancels its

NOTE 10. RELATED PARTY TRANSACTIONS (CONCLUDED)

lease, the bonds must be surrendered and discharged. Title to the entire Park resides in the University and neither the Park nor any payments by the University secures ARPA's bonds. Since the original transaction, IBM has reduced its leasehold to 70% of the building space for periods up to the remaining term of 22 years. Audited financial statements are not available.

The Campus Research Corporation (CRC) is a nonprofit corporation governed by a separate Board of Directors and was established to assist the University in the acquisition, improvement, and operation of the Park and related properties. The CRC currently leases from the University the remaining 30% of the building space of the Park that is not leased to ARPA (see preceding paragraph). The CRC is responsible for assisting in the development of the presently undeveloped portions of the Park and for subleasing unoccupied space, newly developed space, and space now occupied by IBM or its subtenants once the current subleases expire. The University is responsible for payment of operational expenses associated with the space occupied by the University departments, offices, and programs. All income received by the CRC from its activities, after payment of expenses and financial reserves, will be distributed to the University. During fiscal year 2002, $300 thousand was distributed to the University of Arizona.

The CRC's June 30, 2002, audited financial statements disclosed:

- $12.805 million total assets, including $5.277 million in net property and equipment and $5.195 million of net intangible assets, the major components of which relate to leasehold interest and deferred leasing costs.
- $4.778 million total liabilities, including $2.951 million long-term debt in the form of two collateralized notes payable to Wells Fargo, Arizona.
- $6.422 million total revenues, primarily consisting of rental income from the Park and related properties.
- $4.660 million total expenses, including $2.115 million of project operating costs and $683 thousand amortization of intangible assets.
- During fiscal year 2002 cash and cash equivalents decreased by $152 thousand.

The CRC's audited financial statements may be obtained by writing to P.O. Box 210066, Tucson, Arizona 85721-0066.

D. UNIVERSITY MEDICAL CENTER

The University Medical Center (UMC) and the University of Arizona (the University) both provide and receive services from each other under various contracts. Payments to the University by the UMC include resident and intern salaries, utilities, ground maintenance, mailroom operations and various administrative functions. Amounts paid to the University for these services were $14.264 million for the year ended June 30, 2002.

The UMC has entered into contractual agreements with the University to provide support for the academic mission of the University. Charges to the University for such services and facilities provided by the UMC were $10.136 million for the year ended June 30, 2002. These amounts are included in other operating revenue in the accompanying financial statements.

University Physicians, Inc. (UPI) is a not-for-profit corporation whose members are physicians employed by the University and who practice at the UMC. The UMC has agreements with UPI whereby the UPI provides physician and other services to UMC. Additionally, the UMC provides various services to the UPI.

NOTE 11. JOINT VENTURE

UNIVERSITY OF ARIZONA

The University of Arizona (the University) is a participant in the Large Binocular Telescope Corporation (LBT). The LBT was formally incorporated as a not-for-profit corporation in August 1992, pursuant to a Memorandum of Understanding, as amended, executed on February 24, 1989, between the University and the Arcetri Astrophysical Observatory in Florence, Italy (Arcetri). The purpose of the joint venture is to design, develop, construct, own, operate and maintain a binocular telescope currently being

NOTE 11. JOINT VENTURE (CONCLUDED)

constructed in Arizona. The current members of the LBT are the University, Arcetri Research Corporation, Ohio State University and the LBT Beteiligungsgesellschaft.

The University has committed resources equivalent to 25% of the project's construction costs and the LBT's annual operating costs. As of June 30, 2002, the University has made cash contributions of $14.0 million toward the project's construction costs. The University's financial interest represents its future viewing/observation rights. Upon completion of construction, viewing rights will be divided among the participants in proportion to their contributions. According to the audited financial statements of the LBT for the year ended December 31, 2001, assets liabilities, revenues and expenditures totaled $78.0 million, $2.0 million, $9.0 million and $1 million, respectively.

The LBT's separate audited financial statements can be obtained from LBT Project Office, Steward Observatory, University of Arizona, Tucson, AZ 85721-0065.

NOTE 12. COMMITMENTS, CONTINGENCIES AND COMPLIANCE

A. RISK MANAGEMENT INSURANCE LOSSES

The Department of Administration – Risk Management Section manages the State's property, environmental, liability and workers' compensation losses. The State has determined that the management of these losses can be performed effectively and efficiently through the Risk Management Section. Consequently, all agencies and the State's three universities are required to participate in this program. The State's Risk Management Section evaluates the proper mix of purchased commercial insurance and self-insurance annually.

The Industrial Commission provides payment of workers' compensation losses which are not covered by the State Compensation Fund, the Department of Administration –Risk Management Section, private insurance carriers, or self-insured employers. The workers' compensation claims paid by the Industrial Commission encompass losses against uninsured or underinsured employers, insolvent insurance carriers' payments for vocational rehabilitation, medical conditions incurred prior to 1973, apportionment claims for pre-existing industrial and non-industrial related physical impairments and compensation for loss of earnings associated with the disability. The Industrial Commission is totally self-insured.

The management and payment of these losses is accomplished through the funding mechanism of the Risk Management Fund (Internal Service Fund) and the Industrial Commission Fund (Enterprise Fund). As discussed in the following paragraph, an independent annual actuarial analysis is performed to evaluate the needed funding. The Risk Management Section will assess each agency an annual portion of the necessary funding for the Risk Management Fund based on their exposures and prior loss experience. Interest and dividend earnings of investments currently fund the Industrial Commission Fund. To provide funding for workers' compensation claims, the Industrial Commission could direct payment to the State Treasurer an amount not to exceed one and one-half percent of all premiums received by the State Compensation Fund, private carriers and self-insured plans during the immediately preceding calendar year. No such assessments have been made by the Commission since January 1992.

The State records claims liability when the reported loss is probable and reasonably estimated. On an annual basis, independent actuarial firms are engaged to estimate the State's total year-end outstanding claims liability, which takes into account recorded claims and related allocated claims adjustment expenditures, salvage, subrogation, loss development factors and an estimate for incurred but not reported claims.

The Industrial Commission Fund discounts all benefit reserves at three and one-half percent, except for medical. Medical benefits are discounted at an assumed inflation rate equal to the investment rate of return earned by the Industrial Commission Fund. During fiscal year 2002, claims for seven new insolvent medical insurance companies were assigned to the State Compensation Fund and were included in the Industrial Commission's June 30, 2002 actuarial study. The State Compensation Fund, on behalf of the Industrial Commission, has filed proof of claim requests with ancillary receivers, liquidators holding deposits and surety bonds on these insolvent companies totaling $28 million. Since the actual amount that will ultimately be received cannot be determined, the Industrial Commission will continue to recognize receipt of insolvent carrier deposits (no insurance settlement income) as revenue at the time received rather than recording a receivable.

NOTE 12. COMMITMENTS, CONTINGENCIES AND COMPLIANCE (CONTINUED)

Occasionally, the Risk Management Section agrees with claimants to purchase an annuity contract to settle these specific claims when it is determined that it is in the best interest of the State to do so. In these instances, the State requires the claimant to sign an agreement releasing the State from any further obligation. In addition, the State requires that a third party assignment company be named in the contract should the annuity company fail to perform its obligations under the annuity contract. As a result of these requirements, the likelihood that the State will be required to make future payments on these claims is remote.

There have been no significant reductions in the current fiscal year insurance coverage. There have been no settlements that have exceeded insurance premium coverage in the last three years.

The following table presents the changes in claims liabilities balances (short- and long-term combined) during fiscal years ended June 30, 2001and June 30, 2002 (expressed in thousands):

Fiscal Year	Beginning Balance	Current Year Claims and Changes in Estimates	Claims Payments	Ending Balance
Risk Management Fund:				
2001	$ 213,076	$ 86,652	$ 66,051	$ 233,677
2002	233,677	56,306	55,652	234,331
Industrial Commission Fund:				
2001	157,659	5,241	12,430	150,470
2002	150,470	52,892	15,697	187,665

B. LITIGATION

In *Ladewig vs. Waddell,* Ladewig is a class action tax refund case. The class members are seeking refunds for Arizona income tax paid on dividends received from corporations doing less than 50% of their business in Arizona during the years 1986 through 1989. The trial court held that such taxes violated the Commerce clause of the U.S. Constitution and certified the class. The class certification was upheld by the Arizona Supreme Court in 2001. The Tax Court preliminarily approved a proposed settlement on September 23, 2002. Accordingly the State has recorded a long-term liability in its financial statements in the amount of $350 million.

In *Kerr vs. Waddell,* federal employees claim an income tax refund on taxes paid on federal employee contributions. The Board of Tax Appeals granted these claims for the years before 1991, but has denied the claim for later years. The State did not appeal. The plaintiffs appealed for years after 1990. The Tax Court awarded attorneys fees from refunds the State is paying, and this ruling was upheld on appeal. The State has filed a petition for review. The attorneys' fees will be paid from funds otherwise due to taxpayers, so there will be little monetary effect on the State if the fees are awarded. The Tax Court has denied class certification, and ruled for the Plaintiffs on the merits regarding entitlement to refunds for years after 1990. The potential outcome is uncertain at this time. If this case were to have an unfavorable outcome, the State could incur losses ranging from $20 million to $100 million.

In *Hurley Trucking vs. Arizona Department of Transportation*, claimants allege that travel on state, county and city roads built on right-of-ways that cross federal land is not taxable. The Court of Appeals ruled in the State's favor. The Arizona Supreme Court denied a Petition for Review, but ordered the Court of Appeals' decision depublished. The Arizona Department of Transportation has issued a denial of the remaining administrative claims, and the deadline for the claimants to protest further has not run. The potential outcome is uncertain at this time. If the case were to have an unfavorable outcome, the State could incur losses ranging from $72 to $250 million.

In *Roosevelt Elementary School District No. 66 vs. State of Arizona*, the plaintiffs allege the State failed to fully fund the Building Renewal Fund established by the Students FIRST legislation. On October 13, 2000, the court held that the State did

NOTE 12. COMMITMENTS, CONTINGENCIES AND COMPLIANCE (CONTINUED)

not violate the statutory provisions regarding funding of the Building Renewal Fund for fiscal year 1998-99. However, the court held that neither part was entitled to summary judgement regarding funding for fiscal year 1999-00, and that in order to prevail on that claim, the plaintiffs would have to demonstrate that they were injured by the alleged underfunding. On February 21, 2002, the court granted the plaintiffs' motion to file an amended complaint, which included similar allegations regarding funding for fiscal year 2001-02. The parties both moved for summary judgment once again regarding the remaining claims in the case (fiscal years 1999-2000 and 2001-02), and on May 7, 2002, the trial court granted the plaintiffs' motion for summary judgment as to both years. The State timely appealed the decision to the Arizona Court of Appeals. The appeal has been fully briefed, but oral argument has not yet been scheduled. It is probable that the State will be required to provide approximately $88 million in additional funding. Accordingly the State has recorded a long-term liability for this amount.

In *Amcore LLC v. Hull, et al,* a class action brought on behalf of individuals and business entities allegedly damaged by the passage of SB 1004 in December 2000, which reduced benefits available to Taxpayers under SB 1504 passed in April 2000. Plaintiffs claim divestiture of vested rights, denial of due process, impairment of contract, violation of equal protection, and equitable estoppel. Plaintiffs are requesting an order declaring SB 1004 unconstitutional, injunctive relief to stop the state from providing benefits under SB 1004, compensatory damages, pre and post-judgment interest and attorneys' fees and costs. The court has conditionally certified the class. The State has filed a motion to dismiss for failure to exhaust administrative remedies and objection to proposed form of notice to class members. A hearing is set for both motions on November 15, 2002. The potential outcome is uncertain at this time. If this case were to have an unfavorable outcome, the State could incur losses ranging from $30 million to $330 million.

The State has a variety of claims pending against it that arose during the normal course of its activities. Management believes, based on advice of legal counsel, that losses, if any, resulting from settlement of these claims will not have a material effect on the financial position of the State. All losses for any unsettled litigation or contingencies involving workers compensation, medical malpractice, construction and design, highway operations, employment practices, criminal justice, fidelity and surety, environmental property damage, general liability, environmental liability, building and contracts, auto liability, or auto physical damage are determined on an actuarial basis and included in the Accrued Insurance Losses of the Internal Service Funds.

C. ACCUMULATED SICK LEAVE

State employees are eligible to receive payment for an accumulated sick leave balance of 500 hours or more with a maximum of 1500 hours upon retirement directly from State service. The benefit value is calculated by taking the State employee's hourly rate of pay at the retirement date, multiplied by the number of sick hours at the retirement date times the eligibility percentage. The eligibility percentage varies based upon the number of accumulated sick hours from 25 percent for 500 hours to a maximum of 50 percent for 1500 hours. The maximum benefit value is $30,000. The benefit is paid out in annual installments over three years. The Retiree Accumulated Sick Leave Fund is accounted for on the financial statements as an Internal Service Fund and accounts for the retiree accumulated sick leave. Unused accumulated sick leave of employees of the State, excluding Universities, at June 30, 2002, totaled $292.750 million.

D. UNCLAIMED PROPERTY

The State of Arizona's Uniform Unclaimed Property Act requires deposit of certain unclaimed assets into a managed Agency Fund. ARS §44-313 requires a separate trust fund of not less than $100 thousand to be retained for prompt payment of claims. The excess amount, above that which is required to be retained, is required to be deposited to the General Fund where it is included as other revenue. Under a statute that took effect July 1, 1990, up to $1.0 million in unclaimed utility deposits is deposited in the Utility Assistance Fund to help low income and elderly people make utility deposits and repairs. Fifty-five and twenty percent of the remaining net cash collected, after refunds, is transferred to the Department of Commerce Housing Fund to be used for low-cost housing and the State Treasurer for distribution as provided for in ARS §5-113, respectively. The balance is to be deposited in the General Fund. For fiscal year 2002, $868 thousand was deposited in the Utility Assistance Fund, $19.762 million was deposited in the Housing Fund, $7.186 million was deposited with the State Treasurer and $7.656 million was deposited in the General Fund. A total of approximately $222.794 million has been remitted since inception of the fund. In addition, the State is also holding stock valued at $20.082 million. The remittances to the General Fund and the holdings by the

NOTE 12. COMMITMENTS, CONTINGENCIES AND COMPLIANCE (CONCLUDED)

State represent contingencies, as claims for refunds can be made by the owners of the property. The Governmental Accounting Standards Board requires that a liability be reported to the extent that it is probable that escheat property will be reclaimed and paid to claimants. This liability is also reported as a reduction of revenue. This liability is reported in the General Fund because it is the fund to which the property ultimately escheats in Arizona. At June 30, 2002, this amount, reported as Due to Others in the General Fund, is $89.136 million.

E. CONSTRUCTION COMMITMENTS

The Arizona Department of Transportation had outstanding commitments under construction contracts of approximately $686.200 million at June 30, 2002.

F. ARIZONA STATE LOTTERY

Annuities are purchased for all prizes over $400 thousand for which winners will receive the jackpot in annual installments for the Pick on-line game. These annuities are purchased from qualifying insurance companies which have the highest ratings from among A.M. Best Company, Standard & Poor's, Moody, Duff & Phelps or Weiss. The Lottery remains contingently liable on all annuities. Aggregate future payments to prize winners on existing annuities totaled approximately $352.56 million at June30, 2002. Approximately $251.27 million of the total aggregate future payments relate to annuities purchased from five separate insurance companies, of which approximately $105.09 million relates to a single insurance company.

In 1994, an insurance company from which the Lottery purchased annuities during the period 1983 through 1989 was placed under State supervision. At June 30, 2002, remaining aggregate minimum future payments on such purchased annuities approximated $13.744 million. In 1997, an insurance company from which the Lottery purchased annuities in 1986 was placed under State supervision. At June 30, 2002, remaining aggregate minimum future payments on such purchased annuities approximated $2.854 million. During 1999, an insurance company from which the Lottery purchased annuities in 1984 was placed under State supervision but as of June 30, 2000 was removed from State supervision. At June 30, 2002 remaining aggregate minimum future payments on such purchased annuities approximated $569 thousand. As of September 30, 2002, all three insurance companies were current in their required annuity payments. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the operations or financial position of the Lottery.

NOTE 13. TOBACCO SETTLEMENT

The State is one of many states participating in the settlement of litigation with the tobacco industry over the reimbursement of healthcare costs. The settlement money is intended to compensate the State for costs it has incurred in providing health and other services to its citizens that were necessitated by the use of tobacco products. The State expects to receive settlement payments through 2025.

The State received $111.955 million in fiscal year 2002. Future settlement payments are subject to several adjustments, but the amounts are not presently determinable. These adjustments include a "volume adjustment," which could reflect any decreasing cigarette production under a formula that also takes into account increased operating income from sales. Other factors that might affect the amounts of future payments include ongoing and future litigation against the tobacco industry and the future financial health of the tobacco manufacturers. Because the net realizable value of the future settlement payments is not measurable, the State did not record a receivable for the future payments at June 30, 2002.

NOTE 14. CONDUIT DEBT

In December 2001, the Greater Arizona Development Authority (GADA) issued $3.1 million Infrastructure Revenue Bonds, Series 2001B for a public infrastructure project in the City of Flagstaff. GADA's bond structure provides lower borrowing costs for Arizona's communities by diversifying the risk to investors and by sharing financing costs among several borrowers. The GADA Fund is leveraged when GADA issues its bonds, which maximizes loan capacity for communities. An intercept

NOTE 14. CONDUIT DEBT (CONCLUDED)

mechanism for intercepting state-shared revenues for loans to political subdivisions enhances the security of the GADA bonds even further.

The State appropriated $20 million to GADA for the express purpose of securing bonds issued by the GADA. The Series 2001B bonds were issued by GADA to make loans to the participant listed above and constitute special and limited obligations of GADA. The principal of and interest on the bonds are payable solely from the funds which are held in Trust by the Trustee (the "Trust Estate"). The Trust Estate includes debt service payments required to be made by the participants in the Series 2001B bond issue. The principal of and interest premium, if any, on the Series 2001B bonds shall not constitute or give rise to a pecuniary liability on the par of the directors and officers of GADA. The Series 2001B bonds do not constitute a legal debt of the State of Arizona and are not enforceable against the State of Arizona. At June 30, 2002 the outstanding face value of the Series 2001B bonds was $3.1 million and the total outstanding face value of all bonds issued by the GADA was $36.3 million.

NOTE 15. SUBSEQUENT EVENTS

On December 1, 2000, the State of Arizona entered into a lease-to-own agreement with Capitol Mall, L.L.C. for the purpose of construction, occupancy and ownership of two office buildings and related parking facilities located on the capital mall. The State began occupying the buildings on July 1, 2002. The State began making lease payments on October 1, 2002. The scheduled lease payments for fiscal year 2003 will total $3.805 million. In addition, the State will pay to Capital Mall, L.L.C., on a monthly basis, all estimated operating costs as additional rent. The estimated operating costs for the 2003 fiscal period is $1.513 million. The lease is not a general obligation or indebtedness of the State. The State shall have the right to cancel and terminate the lease only at the end of its fiscal period in the event that funds are not appropriated by the Arizona State Legislature or the Department of Administration fails to allocate monies for any subsequent fiscal period with respect to this lease. The State shall have the right, during the lease term, to purchase the Capital Mall, L.L.C.'s right, title, and interest in this project.

On July 1, 2002, the State issued the Series 2002B Certificates of Participation to (i) refund all outstanding Certificates of Participation, Series 1992B, dated as of June 1, 1992, originally issued in the amount of $129,640 million and currently outstanding in the amount of $88,645 million, and (ii) to pay the costs of issuing the 2002B Certificates.

Northern Arizona University issued $31.7 million of System Revenue Bonds in August 2002 for various capital projects and renovations on the main campus. These bonds are secured by a first lien on certain gross revenues and are on parity with the Series 1992A, 1997 and 2002 system revenue and system revenue refunding bonds.

On August 15, 2002, the School Facilities Board issued $278.6 million in State School Improvement Revenue Bonds (Series 2002) to (i) pay the costs of correcting existing deficiencies in school facilities throughout the State and (ii) to pay certain Bond Related Expenses. The Series 2002 Bonds are due July 1, 2003 through 2020. Net proceeds totaled $293.6 million (after receipt of $15.5 million in original issue premium and payment of $570 thousand in underwriting fees and cost of issuance).

On August 22, 2002, the Department of Transportation issued $80.5 million in Excise Tax Revenue Bonds (2002 Series) to (i) finance the costs of design, right-of-way purchase, or construction of certain controlled-access highways within Maricopa County, Arizona, (ii) refund in advance of maturity portions of the Department's outstanding Senior Bonds in the aggregate principal amount of $4.550 million and (iii) pay costs of issuing the Bonds. The 2002 Series Bonds are due July 1, 2005 and December 31, 2005. Net proceeds totaled $84.784 million (after receipt of $4.781 million of reoffering premium and payment of $472 thousand in underwriting fees and cost of issuance).

On November 13, 2002, the Department of Transportation issued $156.475 million in Arizona Transportation Board Highway Revenue Bonds, Series 2002B to (i) finance portions of the Board's Five Year Transportation Facilities Construction Program, (ii) advance refund portions of the Board's outstanding Senior Bonds in the aggregate principal amount of $20.405 million and (iii) pay costs of issuing the Series 2002B Bonds. The Series 2002B Bonds are due July 1, 2007 through July 1, 2022. Net proceeds totaled $165 million (after receipt of $9.462 million reoffering premium and payment of $936 thousand in underwriting fees and cost of issuance).

NOTE 15. SUBSEQUENT EVENTS (CONCLUDED)

In December 2002, the State Treasurer announced that the Local Government Investment Pool (LGIP) currently holds $130.986 million of asset-backed securities issued by NPF-12 trust that are serviced by National Century Financial Enterprises (NCFE). Recently, NCFE has come under investigation by the Federal Bureau of Investigation, the Securities and Exchange Commission and various state authorities for possible fraud and violations of federal and state laws. NCFE has since declared bankruptcy and the trustee for the bonds has informed the State Treasurer that the interest payment due December 1, 2002 was not received. It is likely that the LGIP will incur a loss on the total securities held of $130.986 million. Of the resulting loss to the LGIP, the State would be allocated $14.338 million of its proportional share as a pool participant. The State is pursuing legal action to the fullest extent possible to protect the interests of the LGIP participants.

On January 1, 2003, the School Facilities Board issued $372.730 million in State School Certificates of Participation to (i) to finance the costs of acquiring leasehold interests in the School Sites and constructing and equipping thereon certain school facilities, which will be subleased to various school districts within the State of Arizona, and (ii) to pay the costs of issuing the 2003A Certificates. The 2003A Certificates are due September 1, 2004 through 2017. Net proceeds will total $400 million (after receipt of $29.480 million in original issue premium and payment of $2.210 million in underwriting fees and cost of issuance).

In *Somerton Elementary School District No. 66 V. State of Arizona,* the issues raised in this case are identical to those raised in the *Roosevelt Elementary School District* case and it was assigned to the same trial court judge. Therefore, on October 17, 2002, the trial court entered an order concluding that the current level of funding provided by the State for the Building Renewal Fund for fiscal year 2002-03 was unconstitutional, and also requiring the State to "restore the $90 million to the Building Renewal Fund for 2002-03 school year by June 20, 2003." On November 1, 2002, the State filed a Motion for Reconsideration, contending that it was a violation of the separation of powers doctrine for the court to require the State to appropriate monies by a certain date. That Motion has not yet been fully briefed by the parties. The potential outcome is uncertain at this time. If the case were to have an unfavorable outcome, the State may be required to provide approximately $90 million in additional funding.

GREAT SEAL OF THE STATE OF ARIZONA

DITAT DEUS

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